

EXAMINER'S REPORT

AA3 EXAMINATION - JULY 2018

(AA35) CORPORATE AND PERSONAL TAXATION

Question No. 01 (05 marks)

What was tested?

It was required to identify the resident status according to the given facts for taxation purposes in Sri Lanka for the year of assessment 2016/17. The knowledge on the residency rule was tested.

Observations:

Majority of candidates have obtained high marks for the above question. But certain candidates have not understood the question properly and have done computations in detail. Some of them have arrived at 198 days without deducting for the foreign visits for 30 days. As a result of this they have ended up with an incorrect answer of over 183 days and have incorrectly identified the resident status as a resident. But the correct answer is 168 days and **Steven** is a non-resident according to the 183 days rule.

Candidates should understand that an individual who is physically present in Sri Lanka for one hundred and eighty three days (183) or more (i.e. 6 months or more) during any year of assessment (e.g. from 01st April 2016 to 31st March 2017) shall be deemed to be resident in Sri Lanka throughout that year of assessment.

It is essential to understand what the examiner is expecting from the candidates in such a question. They should also develop a fair knowledge of the residency law.

The performance for this question was satisfactory.

Question No. 02 (05 marks)

What was tested?

- (a) It was required to state the prescribed period to make an appeal against an assessment.
- (b) It was required to state two (02) instances where the Commissioner General of Inland Revenue may grant an extension of time for the submission of late appeals.
- (c) It was required to state two (02) methods by which the Commissioner General of Inland Revenue may recover the taxes in default.

Observations:

It was noted from the answers that candidates have skipped these areas when studying the subject.

- (a) Some candidates have incorrectly stated the prescribed period to make an appeal against an assessment as 45 days, 03 months, 06 months and etc. The correct answer is within 30 days from the date of such assessment.
- (b) Candidates should understand that Commissioner General of Inland Revenue may grant an extension of time for the submission of late appeals due to absence from Sri Lanka, Sickness or other reasonable cause. Some candidates have provided irrelevant and vague answer for this part.

- (c) Some candidates have provided vague answers for this part. They should note that the methods by which the Commissioner General of Inland Revenue may recover taxes in default include seizure of property, recovery through Magistrate's Court, recovery out of debts, transfer of immovable property in lieu of payment and etc.

It is a prerequisite to study the self-study text and the candidates should obtain a thorough understanding in relation to obligations and procedures relating to taxation.

The performance for this question was at an average level.

Question No. 03 (05 marks)

What was tested?

It was required to compute the minimum amount of quarterly income tax payable for each quarter of year of assessment 2016/17 as per the provisions of the Inland Revenue to avoid penalty based on the given details for part (a) and state the due dates for the payment of income tax for each quarter for part (b)

Observations:

- (a) Some candidates have erroneously applied various % such as 10% to the tax on taxable income for the year of assessment 2015/16 which is Rs.10,235,000/-. Some candidates have just stated that the minimum amount has to be $\frac{1}{4}$ th of tax on taxable income for the year of assessment 2015/16 without computing the minimum amount. Some candidates have made arithmetical errors in calculations and could not arrive at the correct amount of Rs.2,558, 750/-. (Rs.10,235,000/4)
- (b) Many candidates have stated incorrect due dates for payment of income tax for each quarter as 10th , 20th of different months. Furthermore candidates should understand that correct due dates for the payment of income tax are 15th August 2016 ,15th November 2016, 15th February 2017 and 15th May 2017.

Candidates should Update the knowledge of the specific due dates for the payment of income tax. Candidates should understand what is expected from the question before answering. Further extra care should be taken to avoid arithmetical errors in the calculations.

The performance for this question was unsatisfactory due to lack of updated knowledge.

Question No. 04 (05 marks)

What was tested?

This question was based on the decided case "Rajapaksa Vs CIT". It was required to explain whether the Assistant Commissioner can disallow the cost of travelling between his residence and the Department of Inland Revenue.

Observations:

Most of the candidates' answers were at an average level. The facts of the various irrelevant cases were quoted by some of the candidates. Some candidates have not explained the main facts clearly.

It is important for candidates to practice similar questions related to case law which will facilitate to present an adequate answer under examinations conditions.

Candidates should understand that, as per the section 26(01) (a) domestic or private expenses including cost of travelling between the residence and place of business is not allowed. However in the instances where an individual's residence could also be a place of business then travelling from his residence to another place of work could be an allowable expense.

The performance for this question was at a moderate level.

Question No. 05 (10 marks)

What was tested?

It was required to compute the divisible profit of the partnership for the year of assessment 2016/17 and the income tax payable by the partnership for the year of assessment 2016/17. It was also required to prepare a statement of distribution of profit and other income of the partners arising from the partnership.

Observations:

- (a) When computing divisible profit, some candidates have erroneously added back rates on the building, rent paid to **Ruwan** and salary paid to **Nuwan's** wife whereas it is allowed in arriving at the divisible profit. Only partners salary to be added back when computing the divisible profit. Although the capital allowance for machinery is 33.33% some candidates have incorrectly used various % such as 20%.
- (b) Though the allowance applicable for partnership was Rs.1,000,000/- some candidates considered the allowance as Rs.500,000/-. Though the tax rate applicable for Y/A 2016/2017 was 8%, some candidates incorrectly applied 10%.

This was fairly a simple question where candidates could have scored marks easily if constant practice was carried out as it was a common question which has been tested previously.

The performance for this question was at a satisfactory level.

Question No. 06 (10 marks)

What was tested?

It was required to assess the balance amount of Nation Building Tax (NBT) payable for the quarter ended 31st March 2017 for part (a) and state the due date for submitting NBT return for the quarter for part (b).

Observations:

It was observed that a considerable number of candidates have answered for this question without understanding the law regarding distributor and wholesale & retail sales under NBT Act.

- (a)
 - Sale of sugar by a distributor is liable for NBT 25% of the turnover (i.e. Rs.8,400,000/- *25%*2%) where as some of the candidates have incorrectly calculated as 75% of the liable turnover. From whole sale & retail sales 50% is liable (i.e. Rs.3,130,000/- * 50%*2%). But certain candidates have done it incorrectly using incorrect %.
 - Majority of candidates have deducted NBT paid by the company of Rs.147,000/- (on purchase of sugar 120,000 and on locally purchased food items Rs.27,000/-) erroneously as tax credits. Candidates should understand that the deductions are allowed of purchase of raw materials from a manufacturing organization only.
- (b) Due date for submitting NBT return for the quarter ended 31st March 2017 was 20th April 2017 .But some candidates have stated different incorrect dates.

It is important to have a sound knowledge of the NBT Act and the amendments to the act.

The performance for this question was at a moderate level.

Question No. 07 (10 marks)

What was tested?

It was required to assess the balance amount of Value Added Tax (VAT) paid for the quarter ended 31st March 2017 for part (a). Further, it was required to state the statutory time limit to claim the input tax as per the given facts as per the provisions of VAT Act for part (b).

Observations:

- (a) Though the correct VAT rate_applicable for the quarter ended 31st March 2017 was 15%, some candidates stated it as 11%. The common mistake which was done by candidates was to charge VAT on sales from public passenger transport. Candidates should understand that public passenger transport is not liable for VAT .Input tax on expenses relating to public passenger transport services is not allowed. But majority of the candidates have considered the same as deductible input tax incorrectly.
- (b) Many candidates have not stated the statutory time limit to claim the input tax as per the given facts as per the provisions of VAT Act for part (b). Candidates should understand that as per the section 22 (6) (iv) (a) , input tax can be deducted from the output tax for any taxable period ending on or before the expiry of twelve months from the date of such tax invoice.

It is important to understand the VAT Act and its exemptions by the candidates.

The performance for this question was at an average level.

Question No. 08 (25 marks)

What was tested?

Computation of corporate income tax according to the Inland Revenue Act No. 10 of 2006 and subsequent amendments up to 31st March 2017 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.

Observations:

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:

- (1) Adjustment for interest on loans from a holding company was tested. Majority of the candidates were not able to answer for the same and it is calculated as follows:

<u>Interest paid to holding company</u>			
Loan from Holding Company	90,000,000		
(20,000,000 + 8,800,000) x 3	86,400,000		
	3,600,000		
Interest Paid	7,127,500		
Disallowable interest	7,127,500/ 90,000,000 X 3,600,000 Or +7,127,500 – 6,842,400		285,100

- (2) Further some of the candidates didn't possess the knowledge that the research expenses are claimable 300% of the value when an independent outside party has carried out the same.

- (3) Management fee is restricted to maximum of Rs.2 million or 1% of the turnover whichever is lower. This adjustment was incorrectly done by some of the candidates.
- (4) Market survey is an allowable expense but it does not qualify for three times of the value as in the research expenses. But some of the candidates have erroneously considered that market survey is also 300% claimable.
- (5) Some candidates have deducted the entire donation of Rs. 12 million as qualifying payment for a community development project in a rural area which has been gazette as an economically marginalized village. It should be noted that, Rs.10 million limit is applicable for Donations of community development work for economically marginalized village in claiming allowance for qualifying payments.
- (6) Tax rate applicable is 28% as there is a holding subsidiary relationship. But some of the candidates have erroneously applied 12% rate. Some other candidates applied personal income tax rates erroneously.

Constant practice of company tax question is a prerequisite for performing well for this question paper.

The performance for this question was at a satisfactory level. However, it is recommend to understand the tax rates applicable to different undertakings.

Question No. 09 (25 marks)

What was tested?

Personal income tax computation for the year of assessment 2016/17 was tested. It was required to assess taxable income, gross income tax payable, balance tax payable and exempt income if any.

Observations:

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.

Common mistakes identified are as follows:

- (1) Some candidates have ignored the fact that one resident is exempted from tax.
- (2) Rent income from furnished apartment was not correctly computed by some of the candidates.
- (3) Some candidates have ignored the fact that the interest income from investment in Treasury Bills is not taxable.
- (4) Cash donation of Rs.50,000/- to the village temple is not a qualifying payment. But some candidates have considered the same as qualifying payment.
- (5) Cash donation of Rs.100,000/- paid to National Kidney fund is allowed 100% as a qualifying payment. Nevertheless some candidates have not considered the same as a qualifying payment.
- (6) Employment allowance of Rs.250,000/- has not been considered by some candidates .
- (7) Employment income of a professional is taxable at the maximum rate of 16% progressively starting from 4%, 8% & 12% respectively. However, there were some candidates who have applied company tax rates also.

The performance for this question was at a satisfactory level.

Hints to Improve Performance:

- (1) Studying well the full contents of the syllabus completely and develop a thorough understanding about the level of knowledge expected for the each unit or area.
- (2) Candidates should read the question carefully a several times and should show all the relevant workings related to the computations with clarity.
- (3) State the assumptions clearly if there are any assumptions involved in answering the questions.
- (4) 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.
- (5) 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. It is always advantageous because the similar patterns and the structures may repeat in the real examination papers.
- (6) 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.
- (7) Handwriting should be legible and the numbers of questions should be correctly written. Re-checking of question numbers etc. before handing over answer scripts is a must.
- (8) Following correctly the instructions given in the question paper is important.
- (9) Referring the **self-study text** is essential and practicing the examples of the **self-study text** is also vital. Refer books, articles, magazines in relation to this subject and other reading materials related to the relevant subject areas.
- (10) Appearing for the examination with a firm determination of passing the examination with due preparation.

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