

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

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

This question tested the residency rule under Section 69 (4) of the Inland Revenue Act No. 24 of 2017 (hereafter referred to as the Act) in relation to a company, which is incorporated in India and planned to expand its business activities to Sri Lanka.

As per the act, 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.

Accordingly, the particular company is a resident company in Sri Lanka for the tax purpose as it was incorporated in Sri Lanka under Section 69 (4) (a) of the act.

**Observations:**

- (1) Considerable number of candidates had mentioned that the company is not resident as it was not yet incorporated in Sri Lanka.
- (2) Some candidates have provided completely irrelevant answers, applying the "183 days rule", which was related to the residency rule of an individual.
- (3) Some candidates have provided lengthy answers without giving correct argument.

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

## Question No. 02

### What was tested?

The question tested the knowledge of Capital Gain Tax (CGT).

### Observations:

- (1) Most of the candidates have applied the correct rate of 10% for capital gain.
- (2) Some candidates have approached a wrong method and arrived at an incorrect answer for capital gain on land disposal, due to considering the purchase cost of the land instead of the market value.
- (3) Some candidates have incorrectly used the market value of quoted shares as at 30.09.2017 instead of the purchased price to compute the capital gain.
- (4) Some candidates have calculated the CGT for quoted shares although it is exempted from tax.

**Performance: The overall performances were at a satisfactory level.**

## Question No. 03

### What was tested?

This case law question was based on the facts of the decided case called *Hayley and Company Limited vs. Commissioner of Inland Revenue (1961) 3 CTC 115*. A company (Ran Kahata) had deducted a net loss that was incurred due to a flood in arriving at profits and income from business for Y/A 2019/20. Further, this particular net loss was deducted after receiving insurance claim.

According to the judgment of the given case, the word “outgoing” is wide enough to cover losses, which are involuntary outgoings. Further, the Supreme Court pointed out that outgoings must be “incurred in the production of profit”. The Assessee’s loss was deductible as being incidental to the business. Accordingly, this net loss can be deducted in arriving at profit from the business as it was incidental to the business of the company.

### Observations:

- (1) Even though it was required to answer the question with reference to the decided case, most of the candidates were failed to do so.
- (2) Some candidates have mixed up the facts of the decided case with other cases.
- (3) Some candidates have just concluded that the particular profit is taxable without proper justification or explanation.

**Performance: The overall performance for this question was at an average level.**

## **Question No. 04**

### **What was tested?**

This question tested the knowledge on Stamp Duty that charges under Section 6 (e) of the Stamp Duty (Special Provisions) Act No. 12 of 2006 (as amended) in case of two separate incidents.

Accordingly, in the first incident, father has to pay Stamp Duty on the land when he made the gift to the daughter, and in second incident, the buyer has to pay Stamp Duty when it was purchased from the daughter.

### **Observations:**

- (1) Almost all the candidates attempted the question; however, they had no correct understanding on the correct application of the provision of Stamp Duty Act.
- (2) Considerable number of candidates have mentioned that daughter is liable to pay Stamp Duty in the first instance.
- (3) Only very few candidates have calculated the correct Stamp Duty for both incidents.
- (4) Some candidates have applied gift related Stamp Duty rates to sale of land and vice-versa.

**Performance: The overall performances were at an 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 manufacturing of bakery items:

### **Observations:**

- (1) Majority of the candidates have applied correctly VAT for the sale of confectionary items.
- (2) Handful of candidates have correctly considered supply of bread as VAT exempt supply and very few candidates correctly calculated VAT for all three items.
- (3) Considerable number of candidates have not correctly treated the input tax claim with regard to purchases related to breads, common expenses and repairs made to Director's motor car.
- (4) Some candidates have recalculated 8% VAT for the given input tax even though it was clearly stated as "input tax" in the question itself.
- (5) The excess input tax brought forward from the previous quarter and the installment payment were deducted by majority of the candidates.
- (6) The knowledge pertaining to input-output mechanism of VAT was understood by the majority

**Performance: Overall performances for this question were at a satisfactory level.**

## Question No. 06

### What was tested?

This question was based on furnishing of return of income for the Y/A 2020/2021 by a limited liability company, which was incorporated in Sri Lanka. It was required to:

- (a) State three items that included in default assessment.
- (b) State four persons who can appoint as an authorized representative, and
- (c) State three conditions that must be complied by the company in making an appeal for an administrative review.

### Observations:

- (1) Considerable number of candidates were failed to answer all three parts of the question correctly due to very poor knowledge in relation to administrative provisions included in the Act.
- (2) Some candidates have provided completely irrelevant answers for part 'a' and 'c' of the question. For example, most of the candidates have provided general answers like date, address, signature etc. as the items that included in the assessment.
- (3) Majority of the candidates were answered **part (b)** using their general knowledge without stating the correct authorized representative as per the Act. Therefore, they were unable to obtain full marks for that part.

**Performance: Overall performances for this question were not at a satisfactory level.**

## Question No. 07

### What was tested?

This question was based on the partnership taxation in terms of Section 53 to 56 of the Act. It was required to calculate the Income Tax payable by the partnership for the Y/A 2021/2022.

### Observations:

- (1) Partner's salary and accounting depreciation have not been correctly added back to the accounting profit when arriving at the business profit of the partnership by a handful of candidates.
- (2) Considerable number of candidates have not done the correct adjustments for capital allowances and have ignored the same.
- (3) Considerable number of candidates have just ignored the rent expense without mentioning that it was allowed as a deductible expense.
- (4) Considerable number of candidates have lost marks due to just claiming Rs.1,000,000/- as partnership allowance without stating that it should be taxed at 0%.

**Performance: Overall performances for this question were at a satisfactory level.**

## Question No. 08

### What was tested?

The fundamental theoretical knowledge on corporate taxation for the Y/A 2021/2022 was tested by this question. Accordingly, the question was required to:

- (1) Assess the Assessable Income, Taxable Income, Gross Income Tax payable, and balance tax payable of a resident company, which was incorporated in Sri Lanka.
- (2) To identify the Income Tax rate applicable when the company is engaged in the business of importing and selling of toys when annual turnover is 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 this question. Considerable number of candidates have secured reasonable marks for this question.

(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 were unable to follow the same.

(3) **Other income:**

Almost all the candidates have eliminated rent income, dividend income, interest income on fixed deposit, and profit on disposal of motor vehicle as separate source 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 the majority. Further, most of the candidates have correctly applied the respective rates in granting capital allowances as provided in the Act. However, some were unable to do so. Even though, some candidates correctly calculated the capital allowances, but that amount was not added back to the accounting profit.

(5) **Disallowable expenses:**

Provision for gratuity, entertainment expenses, and donation have been added back to the accounting profit by almost all the candidates. Foreign tour expenses to meet suppliers and local media advertising were not allowed by most of the candidates. Even though, some candidates have stated that those expenses are allowable, they were again deducted from the accounting profit.

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

The donation made to the Ministry of Health has fully claimed by the majority. However, certain candidates claimed this donation subject to limitation of Rs.500,000/- or 1/5 of Taxable Income without considering that the said donation was made to the government in kind.

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

The company was engaged in the business of importing and selling toys to the domestic market for which 24% tax rate is applicable, as the turnover of the company exceeds Rs.500 million. On the other hand, the company has received a dividend income on investment for which the maximum rate of 14% must be applied.

Only few candidates have applied both the tax rates correctly to assess the gross tax liability of the company. However, most of candidates have applied the standard rate of 24% for the entire profit by ignoring the dividend income. Few candidates have applied the individual tax rates to this corporate tax computation.

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

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

**Performance: Overall performance for this question was at a satisfactory level.**

## **Question No. 09**

### **What was tested?**

Computation of personal Income Tax for the Y/A 2021/2022 of a resident individual who worked as an Engineer by profession. The source of income included income from employment and investment.

### **Observations:**

The question was attempted by almost all the candidates, and the fundamental knowledge of individual taxation was at a satisfactory level. The common mistakes observed during the process of evaluation are summarized as follows:

**(a) Employment Income:**

- (1) Some candidates have taken monthly salary as gross salary for the entire Y/A without annualizing to get the total benefit of employment.
- (2) Some candidates have deducted 50% reduction for travelling allowance, and some were not considered it as an employment income.
- (3) The medical bill reimbursement was not considered as an employment income by many candidates. Those candidates have assumed that it was paid on non-uniform basis even though the question has clearly mentioned that it was paid on uniform basis.
- (4) The annual bonus was not taken as employment income by considerable number of candidates.
- (5) The housing benefits have considered as employment income by the majority.
- (6) Some candidates have taken the entire amount of telephone bill reimbursement without taking into consideration 50% of it.

**(b) Income from investment:**

- (1) Rent income was correctly considered as investment by the majority. But, some candidates have taken it as a business income.
- (2) Considerable number of candidates treated the interest income from RFC account as an exempt income. But, some candidates included it in the Assessable Income.
- (3) Dividend received out of dividend was not understood by majority and it was included under the Assessable Income from investment.

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

- (1) Some candidates attempted to accomplish the computation by adding and subtracting the given donation, interest paid, education expenses etc. as in the question itself.
- (2) Most of the candidates have incorrectly claimed the 25% of repair allowances from Investment Income instead of claiming from qualifying payments and reliefs.
- (3) Both the interest and capital portion of housing loan have been erroneously claimed as a qualifying payment by many candidates instead of claiming only the interest portion.
- (4) The foreign education expenses have been erroneously claimed under expenses relief in which only local education expenses are claimable.
- (5) Personal relief Rs.3,000,000/- has been correctly claimed by the majority under relief. However, some candidates have applied previous Y/A tax free allowance of individual Rs.500,000/- and employment allowance Rs.700,000/- as personal relief.

- (6) Donation made to the government has been correctly claimed by the majority. But, certain candidates have claimed such donation subject to the maximum limitation of Rs.75,000/- or 1/3 of Assessable Income by ignoring that the particular donation is made to the government in kind.
- (7) The most candidates have applied the correct tax rates with correct slabs to tax the Taxable Income. However, certain candidates have applied tax rates and slabs in the old Act.
- (8) Claiming tax credit as APIT and self-assessment payments were in a satisfactory level. But, certain candidates were unable to identify & treat tax credits correctly. For example, tax credits have been claimed from Taxable Income without computing the tax liability of the person.
- (9) Some candidates have not applied the correct flow of the individual return of income when reaching total Assessable Income, qualifying payments 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 Assessable Income.
- (10) Some candidates have stopped the computation after arriving at Taxable Income without completing the rest of the answer.

**Performance: Overall performances for this question were at a satisfactory level.**

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

- (1) Ignoring fundamental principles in taxation and relevant laws and devoting too much attention on arithmetical calculation.
- (2) Lack of awareness on relevant taxation laws such as Stamp Duty and the new Inland Revenue Act and its subsequent amendments.
- (3) Poor attention in reading the question paper properly before starting to answer the questions, resulting to omit 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 taxation laws have been properly explained.
- (6) Poor time management in answering the question paper.
- (7) Some candidates failed to understand the requirements of the new Inland Revenue Act No. 24 of 2017, and still provide answers based on the old Inland Revenue Act No. 10 of 2006.



- (8) Illegible handwriting that created difficulties for Marking Examiners to understand the facts of answers. Sometime it was impossible for examiners to read answers because of being very untidy or not clear.
- (9) Lack of relevant workings for answers or workings were not properly linked with the computations, resulting Marking Examiners to not been able to grant full marks allocated for the questions.
- (10) Some candidates have not shown 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 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 model 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.
- (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 understand that candidates are not allowed to make unrealistic assumptions to alter the given facts of the questions.
- (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 Marking 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, to 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.