

EXAMINER'S REPORT

Level III EXAMINATION - JANUARY 2026

(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) (as amended) of a company, that was incorporated in Sri Lanka.

Accordingly, under Section 69 (4) of the Act, a company shall be resident in Sri Lanka for a year of assessment if,

- (1) It is incorporated or formed under the laws of Sri Lanka,
- (2) It is registered or the principal office is in Sri Lanka, or
- (3) 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 attempted the question.
- (2) The majority of candidates have correctly answered the question.
- (3) Although the conclusion of certain candidates was correct, the answer was incorrectly based on the 183 days rule that is applicable to an individual.

Performance: The performance was at a satisfactory level.

Part (b)**What was tested?**

This part of the question required candidates to state two indirect taxes applicable in Sri Lanka.

Observations:

- (1) The majority of candidates have provided correct answers.
- (2) A considerable number of candidates have mixed up direct and indirect taxes.
- (3) Some candidates have mentioned several previously abolished taxes as well as certain unknown taxes, which are not recognized under the indirect taxes.

Performance: The performance was at a satisfactory level.

Question No. 02

What was tested?

This question tested the knowledge of candidates pertaining to Capital Gain Tax (CGT) which is imposed under Section 7 (2) (b) of the Act as gains from realization of investment assets as calculated under Section 36 to 51 of the Act. The disposal of assets included,

- (1) An Inherited residence house used from 2010
- (2) A rubber estate that earned income from rubber.
- (3) Bare land in Matale which was purchased in 2014.

Observations:

- (1) An average number of candidates failed to identify the cost of each asset that must be taken into account for the capital gain.
- (2) Some candidates incorrectly calculated the capital gain by aggregating the consideration, cost, and broker fees of all three assets and applying the tax rate to the entire capital gain.
- (3) A considerable number of candidates incorrectly applied different tax rates instead of the correct tax rate of 10%.

Performance: The performance was at an average level.

Question No. 03

What was tested?

This case law question was based on the facts of the judgment held by the Supreme Court of Sri Lanka in Davoodbhoy vs. CGIR (1979) 4 SLTC 122.

The given question described a firm (**X & Co.**) operating as a partnership between **Arjun** and **Priyal**, who agreed to share profits and losses equally. **Arjun** decided to create a sub-partnership with his friend **Sameera**. Under the sub-partnership agreement, **Sameera** was entitled to receive 25% of **Arjun's** share of profits from **X & Co.** The sub-partnership had a separate agreement between **Arjun** and **Sameera** and did not affect **Priyal's** share.

The question required an explanation of the Income Tax implications of this arrangement between **Arjun** and **Sameera** by referring to Davoodbhoy vs. CGIR.

As per the facts of the case, Abasbhoy Davoodbhoy was one of five partners in the Abdul Hassen Davoodbhoy partnership and was entitled to receive a one-fifth share of the partnership. However, he entered into another agreement with his children to share his one-fifth share of the partnership.

Under the agreement, the capital and goodwill of the partnership remained the separate property of appellant Davoodbhoy. The only asset included in this new agreement was his one-fifth share of the Abdul Hassen Davoodbhoy partnership. However, this agreement was rejected by both the Commissioner General of Inland Revenue and the Board of Review.

The case first came to the Court of Appeal, which decided that a valid partnership cannot exist if the agreement merely shares the profits and losses of one partnership in another partnership without any additional substance.

Finally, the case reached the Supreme Court as a question of law. It was held that the agreement was not artificial or fictitious but incorporated a genuine family arrangement that was very common in our society.

However, Section 195 of the Act does not allow such sub-partnership agreements, as it defines a partnership as “an association of two or more individuals or corporations carrying on business jointly for the purpose of making profit, irrespective of whether the association is recorded in writing.”

Observations:

- (1) Only very few candidates correctly identified the facts of the given case and provided the expected answer by referring to the case.
- (2) Even though the question required an answer with reference to the given case, most candidates failed to do so.
- (3) The majority did not adequately describe the given case, and they simply repeated the question itself rather than providing a substantive answer.
- (4) Some candidates concluded that there was a valid partnership without proper justification or explanation.
- (5) Some candidates wrote lengthy paragraphs and repeated the question itself, but the important points that should have been included in the answer were completely missing.

Performance: The performance was not at a satisfactory level.

Question No. 04

Part (A)

What was tested?

This question was required to assess the Tourism Development Levy (TDL) for the quarter ended 31st March 2025 for the given scenario.

According to the Finance Act, if an institution's turnover does not exceed Rs. 12 million per year or Rs. 3 million per quarter, the applicable TDL rate shall be 0.5%. Further, in terms of Section 13(a) of the Finance Act, the turnover in relation to a tourist hotel means the amount received or receivable from total sales, excluding service charges of up to 10% of such sales and the VAT charged on such sales.

Observations:

- (1) Most candidates took a poor approach in answering the question by applying 1% to the entire revenue, including service charges, which should have been excluded.
- (2) A considerable number of candidates applied TDL rates other than 1%.

Performance: The performance was not at a satisfactory level.

Part (B)**What was tested?**

This part of the question required candidates to calculate the Share Transaction Levy Payable by a quoted company listed in Colombo Stock Exchange as per the given details.

Observations:

- (1) The majority of candidates did not provide accurate calculations. Some students confused the WHT rate for parts “A” and “B.”
- (2) Many others applied incorrect rates to calculate the Share Transaction Levy.
- (3) Some candidates used tax rates of 30% or 3% instead of the correct rate of 0.3%.
- (4) Generally, most candidates calculated the value of the transaction correctly but applied an incorrect tax rate.

Performance: The performance was not at a satisfactory level.

Question No. 05**What was tested?**

This question required candidates to assess the balance of Value Added Tax (VAT) payable or (overpaid) for the quarter ended 31st March 2025 by a company engaged in manufacturing and selling footwear items for both export and domestic markets.

Observations:

- (1) The majority of candidates attempted in answering the question and secured more than the average marks.
- (2) Despite the standard VAT rate of 18% being explicitly stated in the question, some candidates applied incorrect rates, such as 12% or 15%, in their computations, indicating a lack of attention to detail or reliance on memorized rates from outdated study materials rather than reading the specific requirements of the paper.
- (3) The difference between “exempt supplies” and “zero-rated supplies” was not understood by many candidates, who treated export sales as exempt supplies rather than zero-rated supplies.

- (4) A common arithmetical error was the misinterpretation of the figures provided in the scenario. Many candidates erroneously treated the gross sales values as the VAT amount itself (i.e., failing to calculate 18% of the value). Conversely, for input tax, some candidates attempted to calculate a rate from the given tax amount rather than using the verified input tax figure, resulting in inflated or deflated tax liabilities.
- (5) Considerable number of candidates claimed input tax on repairs to the director's motor car. This item is a specifically blocked input tax credit under the VAT legislation, as the vehicle is not used wholly for business purposes.
- (6) Many candidates erroneously treated the excess input VAT brought forward from the previous quarter as an additional tax liability, adding it to the payable amount instead of deducting it from output tax or offsetting it against the current quarter's liability.
- (7) Some candidates assumed that the stated figure of Rs. 1,500,000 was a monthly amount and multiplied it by three to arrive at a quarterly total, disregarding the fact that the question generally implies the total amount paid and failing to read the question properly.
- (8) Most candidates failed to secure marks for the relevant headings in the computations because they did not indicate what they had arrived at through their calculations.
- (9) Some candidates still answered the question using the ledger account method (T-Account), disregarding the correct format of the VAT return. This is not a recommended method for formal tax computations, as it lacks transparency in showing the buildup of the liability. Candidates are advised to use a standard vertical computation format.
- (10) Some candidates arrived at the correct answer without following all the steps outlined in the marking scheme

Performance: The performance was at a satisfactory level.

Question No. 06

What was tested?

This question tested the fundamental knowledge of partnership taxation in terms of Sections 53 to 56 of the Act. The question required candidates to calculate the Income Tax payable by a partnership for the Y/A 2024/25, which included:

- (1) Partners' salaries,
- (2) Salary paid to a partner's son who worked as the Manager of the partnership,
- (3) A motor lorry belonging to a partner that was used to deliver goods, for which the partnership paid monthly rent.
- (4) Donation made to the government hospital, and,
- (5) Other income.

Observation:

- (1) Almost all candidates attempted the question, and the majority secured more than the average marks allocated for it.
- (2) A fundamental error was observed in the treatment of partner-related expenses. Some candidates failed to identify that salaries paid to partners are not allowable deductions for the partnership, as they constitute an appropriation of profit rather than a business expense.
- (3) While some candidates correctly identified that payments to a partner's relative (the manager of the partnership) and rent paid to a partner for business use could be allowable, others disallowed them without reasoning or simply ignored them. Candidates are reminded to assess expenses based on whether they are wholly and exclusively incurred for the purpose of the business, regardless of the recipient.
- (4) Some candidates struggled to distinguish between accounting depreciation and tax-allowable capital allowances, often retaining the depreciation charge in the computation without making the necessary adjustment for the purchase of new audio equipment.
- (5) Some candidates did not add back donations to the accounting profit but incorrectly deducted them as qualifying payments, and some ignored donations under qualifying payments.
- (6) A significant conceptual weakness was evident in the application of tax rates to the taxable income of the partnership. Some candidates erroneously applied the progressive tax slabs used for assessing individual income tax. This suggests a failure to understand that partnerships are generally treated as transparent entities for tax purposes, or that specific tax treatment applies to the entity.
- (7) Some candidates displayed a lack of precision in using technical tax terminology. A common error was the confusion between the "Tax-Free Allowance" and the "Zero-Rated" tax slab. They incorrectly labeled the initial Rs.1,000,000/- as a "Tax-Free Allowance" instead of recognizing it as a taxable band subject to a zero per cent rate. This distinction is crucial for the accurate preparation of tax computations and reflects a superficial understanding of the tax structure.

Performance: The performance was at a satisfactory level.

Question No. 07**What was tested?**

This question tested the candidates' knowledge of the administrative framework and compliance procedures, including return submission, penalties for non-submission, the time bar provisions under which the Assistant Commissioner may amend an original assessment and issue an amended or additional assessment in instances such as fraud or gross/wilful neglect by a taxpayer, and matters that must be included in an advance assessment.

Observation:

- (1) While many candidates demonstrated a general awareness of the tax administration process, their performance was marked by a lack of precision regarding specific dates and a superficial understanding of the statutory provisions.
- (2) **Part A (a)** required candidates to state the due date to submit the return of income for the year of assessment 2024/25. In determining the due date of the return of income, a common observation was the omission of the specific calendar year. While many candidates correctly identified the due date as 30th November, they failed to specify the relevant year (e.g., 30th November 2025 for the Year of Assessment 2024/25).

In the context of a specific year of assessment, citing the exact date, including the year, is critical for a complete and legally accurate answer. Ambiguity regarding the year indicates a lack of understanding of the tax year cycle.

- (3) **Part A (b)** required candidates to state the penalties that could be imposed for failure to furnish a return of income under the provisions of the Inland Revenue Act No. 24 of 2017. Only a few candidates provided the expected answer, while others provided completely irrelevant responses, which are not acceptable under any circumstances.
- (4) **Part B (a)** required candidates to state the time bar provisions for two instances: (i) where a taxpayer has filed a self-assessment return, and (ii) in cases of fraud or gross/willful neglect by a taxpayer under Section 135 of the Inland Revenue Act No. 24 of 2017, under which the Assistant Commissioner may amend an original assessment and issue an amended or additional assessment.

Most candidates provided general answers without referencing the specific time limits or legal distinctions required by the Act. As a result, they often failed to state the exact time limits for amending assessments (e.g., the specific number of months or years within which the Assistant Commissioner may act).

The distinction between standard cases and those involving fraud or gross/wilful neglect was often blurred, with candidates failing to clearly articulate how the time bar provisions differ in these exceptional circumstances.

- (5) **Part B (b)** required candidates to state the matters to be included in an advance assessment. Many candidates struggled to list the specific statutory matters that must be included in an advance assessment, offering vague descriptions rather than the precise legal requirements.

Performance: The performance was not at a satisfactory level.

Question No. 08

What was tested?

The fundamental knowledge on corporate taxation for the Y/A 2024/25 was tested by this question. Accordingly, the question was required to assess the Assessable Income, Taxable Income, Gross Income Tax payable, and Balance Tax Payable/Overpayment by a resident company, which was engaged in manufacturing and selling and to 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 candidates attempted the question, and the majority secured at least average marks of the marks allocated for it.

(2) Presentation format:

The presentation and identification of the statutory contents of the corporate Income Tax computation were well understood by the majority. However, a few candidates are still experiencing difficulties in keeping up with the statutory contents and the presentation of the corporate Income Tax computation.

(3) Other income:

Most candidates eliminated the gross interest and rent income as separate sources of income from the accounting profit when arriving at business income.

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

Book depreciation was added back to the accounting profit by almost all candidates. Further, the majority applied the correct rate of 5 years to claim capital allowances for plant and machinery, motor vehicles, furniture, and fittings. In addition, the 20-year capital allowance rate was correctly applied to buildings.

However, most candidates failed to calculate the assessable charges on asset disposal. Furthermore, this amount was not added back to the accounting profit by many candidates, even when it had been calculated correctly.

(5) Disallowable and allowable expenses:

Provision for gratuity and doubtful debts, entertainment expenses for the annual trip, fines and penalties, and donations were correctly added back to the accounting profit by the majority as disallowable expenses.

Bad debts written off, entertainment expenses for client receptions, legal and professional expenses, and foreign travelling expenses were correctly allowed by the majority. However, the brought-forward loss was not claimed by almost all candidates in arriving at business income.

(6) Investment income:

Interest from fixed deposits and rental income were correctly treated as investment income by many candidates.

(7) Qualifying payments and reliefs:

Donations made to local government institutions were correctly claimed in full by the majority. However, some candidates incorrectly claimed them under the restriction of the lower of one-fifth of the taxable income or Rs.500,000/-.

(8) Identification of tax rate:

The majority correctly identified the corporate tax rate of 30%. However, a few candidates still applied the individual progressive rates (6% to 36%) when taxing a company.

(9) Identification of tax credit:

The quarterly installment payment was claimed as a tax credit by the majority. However, withholding tax on interest and AIT on rent were not claimed by many candidates.

Performance: The performance was at a satisfactory level.

Question No. 09

What was tested?

This question required candidates to ascertain the personal Income Tax for the Y/A 2024/25 of a resident individual who worked as a manager at a company. The sources of income included employment, business, and investment income.

Observations:

The question was attempted by almost all candidates, and above average number of candidates secured more than average from the allocated marks.

(a) Employment income:

- (1) The majority included the gross salary as employment income, whereas some candidates considered only the monthly salary in their computations.
- (2) Most candidates failed to include the conveyance benefit, which must be taken as Rs. 40,000 (Rs. 20,000 for the motor car and Rs. 20,000 for fuel).
- (3) Medical bill reimbursements were not included as employment income by the majority.
- (4) Reimbursements for foreign travel expenses and residence benefits were not included by many candidates.

(b) Investment income:

- (1) The gross amount of interest from fixed deposits and treasury bills was correctly taken as investment income by many candidates.
- (2) Gains from the sale of shares of quoted public companies and dividends received were not recognized as exempt by the majority of candidates.

(c) Common omissions and mistakes:

- (1) Not claiming Rs.1,200,000/- as personal relief.
- (2) Not claiming 25% of gross rent under tax reliefs in arriving at Taxable Income.
- (3) Claiming incorrectly tax credits from Taxable Income directly without computing the tax liability.
- (4) Applying progressive rate ranging from 6% to 60% or sometime more to estimate tax liability.
- (5) APIT on employment income and AIT/WHT deducted on interest were not claimed properly as tax credits.
- (6) Deducting the tax installments paid before calculating the gross income tax liability.
- (7) Not applying 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 instance, qualifying payments and quarterly installments payments have been claimed prior to the Assessable Income.
- (8) Some candidates stopped the tax computation at taxable income without completing the remaining steps of the calculation.

Attempting to fit the entire answer on a single page made it difficult for the marking examiners to award marks, as some of the workings were unclear.

Performance: The performance was at a satisfactory level.

- - - -

The Overall Performance:

Common Reasons for Certain Poor Performances:

- (1) Devoting too much attention to arithmetical calculation rather than fundamental principles in taxation and respective taxing laws.
- (2) Lack of awareness of relevant taxing laws, their subsequent amendments, and the specific provisions regarding the question.
- (3) Poor attention to reading the question paper properly before starting to answer the questions. This resulted in forgetting 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 examination skills.
- (5) Paying less attention to the study pack in which most of the 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 small marks.
- (7) Certain realistic assumptions were missing while unrealistic assumptions were made.
- (8) Failing to understand the actual requirement of each question properly, which prevents candidates from organizing the answer, including the format and presentation.
- (9) Illegible handwriting created difficulties for examiners in understanding the facts of answers. Sometimes, answers were impossible or almost impossible to read because they were very untidy or not clear.
- (10) Lack of relevant workings for answers, or workings were not properly linked with the computations, resulting in examiners being unable to grant full marks allocated for the questions.
- (11) Some candidates did not show the proper workings to support the figures they have arrived at in the process of calculation.

Suggestions for Improvements:

- (1) Paying attention to time management before answering the question paper, which allows candidates to understand certain important requirements of the questions. It is of utmost importance to summarize the answer as much as possible based on the requirements of the questions and marks allocated.

- (2) Answering past question papers and checking them against model answers in order to improve examination skills.
- (3) Devoting full attention to the study pack because all areas of the question paper are covered by the study pack. It is important to bear in mind that there is a possibility of testing different areas in the study pack.
- (4) Stating clear and realistic assumptions, which are useful in granting certain marks for answers. It is important to remember that candidates are not allowed to make unrealistic assumptions to alter the given facts of the questions themselves.
- (5) Focusing on fundamental principles of taxation rather than the arithmetical accuracy of calculations.
- (6) Providing appropriate workings for each calculation whenever necessary and linking them properly with relevant answers.
- (7) Answering the question paper with legible handwriting that allows the examiners to understand the facts clearly.
- (8) Answering a new question on a new page of the answer booklet.
- (9) Candidates are advised to read the question paper more than once and avoid writing irrelevant answers and calculations that will save time.
- (10) Always use the reading time of 15 minutes to read the question paper fully and then start to answer questions based on the confidence level of each question.
- (11) Practice the conversion of accounting profit to taxable profit, paying close attention to standard adjustments such as disallowable partner salaries and the substitution of depreciation with capital allowances.
- (12) Master certain technical definitions in corporate and individual taxation to ensure accuracy in reporting.
- (13) Practice the conversion of accounting profit to taxable profit, paying close attention to standard adjustments such as disallowable expenses and the substitution of depreciation with capital allowances.
- (14) Candidates must develop the habit of providing complete and precise details, including the calendar year when stating due dates.
- (15) Answers regarding legal provisions should be specific and reference the relevant sections or exact timeframes defined in the Act, rather than relying on general knowledge.