

EXAMINER'S REPORT**Level III EXAMINATION - JULY 2023****(304) CORPORATE & PERSONAL TAXATION**

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

This question was tested the residency status under Section 69 of the Inland Revenue Act No. 24 of 2017 in relation to an individual who was an Australian national, appointed as an officer of the Australian High Commission in Sri Lanka with effect from 01.05.2022 for a period of two years.

Accordingly, in terms of Section 69 (1) (c) of the Act, an individual shall be a resident in Sri Lanka for a year of assessment (Y/A), if such individual,

- (1) Resides in Sri Lanka, or
- (2) If the individual 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 twelve month period that commences or ends during the year.

Accordingly, **Jason** is a resident person in Sri Lanka for Y/A 2022/23 as he has stayed in Sri Lanka for more than 183 day (335 days from 01.05.2022 to 31.03.2023).

Observations:

- (1) Almost all the candidates have attempted the question.
- (2) The most of candidates understood the factors of the question and provided the correct answer.

Performance: The performance was good.

Question No. 02**What was tested?**

This question was tested the fundamental knowledge of Capital Gain Tax (CGT), which is charged under Section 7 (2) (b) of the Act. The transactions included gain from disposing

- (1) Permanent resident with furniture, and
- (2) Marshy land.

Accordingly, gain from disposing the permanent resident is exempted from CGT, whereas gain from disposing the marshy land is subject to CGT at 10%.

Observations:

- (1) The most candidates were not known that gain from disposing a permanent resident, which was owned by a person continuously for 3 years and lived for at least 2 years is exempted from CGT.
- (2) The majority has taxed the capital gain at 10% while some candidates have aggregated the both gains to do so.
- (3) Further, the most of candidates have correctly recognized the consideration less cost and broker fee on disposal of the land to reach capital gain.
- (4) However, the majority of candidates were not aware about the correct date for CGT return submission.

Performance: The performances were in a satisfactory 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 the case of *Davoodbhoy vs. CGIR (1979) 4 SLTC 122*. The question was required to provide the answer in line with the said case for a situation in which two partners carry out partnership to share profits and losses equally. The important aspect was that one partner has entered into another agreement with his two sons to share his profit share of the main partnership. The only revenue of this new partnership was the 50% share of the main partnership.

The question was whether is there a valid partnership between partner and his two sons in terms of the judgment of the given case as well as provisions of the act.

As per the facts of the above case, Abasbhoy Davoodbhoy was one of the five partners of Abdul Hassen Davoodbhoy partnership, and was entitled to receive a one fifth share of the partnership. He has entered into another agreement with his children to share his one fifth share of the said partnership. Under the agreement, the capital and goodwill in the partnership was a property of appellant Davoodbhoy was to remain his separate assets. The only asset of that new agreement was the one fifth share of Abdul Hassen Davoodbhoy partnership. But this agreement was rejected by both the Commissioner General of Inland Revenue as well as the Board of Review.

First, it came to the Court of Appeal and decided that there cannot be a valid partnership if the agreement is merely sharing the profits and losses of one partnership in another partnership without anything more.

Finally, the case came to the Supreme Court by way of question of law, it was held that the agreement was not artificial and fictitious and it incorporates a family arrangement that was genuine and very common in our society.

However, Section 195 of the act does not allow the above type of sub partnership agreement by defining that a “partnership means 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”.

Hence, as per the above definition, sub partnership formed among children is valid in law provided that if carrying on business jointly for the purpose of making profit.

Observations:

- (1) The most of candidates still not understand how to apply the facts of a given question to a decided case law.
- (2) Even though the question was required to answer with reference to the decided case and provisions of the act, the most of candidates were failed to do so.
- (3) Some candidates were concluded that there is a valid partnership without proper justification or explanation.
- (4) Only very few candidates have correctly identified the facts of the given case and provided the expected answer by referring to the both case law as well as provisions of the act.
- (5) Some candidates have written lengthy paragraphs and question itself repeatedly, but the important points that should be included in the answer were completely omitted.

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

Question No. 04

Part (a)

What was tested?

This particular question was required to state 3 items that are included in a valid tax invoice in terms of Value Added Tax Act No. 14 of 2002.

Observations:

- (1) The expected answers were provided by the majority.
- (2) However, few candidates have provided completely irrelevant answers.

Performance: The performances were good.

Part (b)

What was tested?

This part of the question was required to state the applicable Social Security Contribution Levy under Social Security Contribution Levy Act No. 25 of 2022.

Observations:

- (1) The expected answer 2.5% was provided by many candidates.
- (2) However, considerable number of candidate still not aware the correct tax rate.

Performance: The performances were good.

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 31.03.2023 by an entity, which was engaged in providing security services.

Observations

- (1) The majority of candidates have secured at least 50% marks allocated for the question.
- (2) Some candidates have followed an accounting approach by creating a special account called "VAT Account" by debiting and crediting the respective information in the given question itself. Those candidates have completely ignored the some important requirements of the VAT return, which are mandatory in furnishing the VAT return.
- (3) Even though question itself has provided the applicable VAT rate as 15%, certain candidates have applied different rates such as 8%.
- (4) The excess input tax brought forward from the previous period and installment payment were claimed by the majority.
- (5) The knowledge pertaining to input-output mechanism of VAT system was understood by the majority.

Performance: The performances were good.

Question No. 06

What was tested?

This question was related to a company, which was incorporated on 01.05.2021 under the Companies Act No.07 of 2007 and commenced its business operations on the same day. The company has registered with Department of Inland Revenue, it has not submitted the Return of Income for the Y/A 2021/22 yet. Further, no payment of income tax was made during the Y/A. The Assistant Commissioner has issued a default assessment based on his judgment.

The question was required to:

- (a) State 4 persons who can be appointed as an authorized representative by the company as per Section 195 of the act.
- (b) State the applicable penalties for failure to furnish a return of income as per the provisions of the act.
- (c) Explain the difference between a “Self-Assessment” and a “Default Assessment”.

Observations:

- (1) The overall performance was below the average level, and the majority has scored less than 50% marks allocated for the entire question.
- (2) Some candidates have answered for the **part (a)** of the question by mentioning the various names of irrelevant persons as authorized representatives.
- (3) Answering the **part (b)** of the question was not in a satisfactory level at all. The most candidates do not aware about the consequences that have to be encountered if a taxpayer does not furnish return on income on or before due date 30th November immediately after the Y/A.
- (4) The difference between a “self-assessment” and a “default assessment” was not known by the majority.

Performance: The overall performance on tax administration was not in a satisfactory level.

Question No. 07

What was tested?

This question was tested the fundamental partnership taxation knowledge in terms of Section 53 to 56 of the act. The question was required to calculate the Income Tax payable by a partnership for the Y/A 2022/23, which included partners’ salaries, ground rent paid to a partner for using it by the partnership, donation, book depreciation, and salary paid to partner’s husband who works as a manager.

Observations:

- (1) The most candidates have secured at least 50% to 75% marks allocated for the question.
- (2) Partner’s salary have correctly added back to the accounting profit when arriving at the business profit of the partnership by the majority.
- (3) Ground rent paid to a partner and an allowance paid to a partner’s husband has been allowed by the many candidates.
- (4) Business income and interest income were separately ascertained by many candidates in arriving at Assessable Income of the partnership.

- (5) Some candidates have forgot to claimed donation under qualifying payments and relief in arriving at Taxable Income.
- (6) Taxing first Rs.1,000,000/- at 0% and balance at 6% were correctly done by many candidates.
- (7) Some candidates erroneously calculated the interest income by adjusting WHT, and finally claimed such WHT as a tax credit.
- (8) Some candidates have incorrectly claimed Rs.1,000,000/- as partnership allowance without taxing at 0%.

Performance: The performances were good.

Question No. 08

What was tested?

The fundamental theoretical knowledge on corporate taxation for the Y/A 2022/23 was tested by this question on the basis of the amendments, which were made to the act with effect from 01.01.2023.

Accordingly, the question was required to,

- (a) Compute the Assessable Income, Taxable Income, gross Income Tax payable, and balance tax payable by a resident company, which was engaged in importing and selling articles to the local market.
- (b) 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 secured more than 60% of marks allocated for the 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 are still experiencing difficulties to keep up with statutory contents and presentation of corporate Income Tax computation.

- (3) Other income:

Almost all the candidates have eliminated the gain from disposal of assets, interest income, dividend income, and rental income as separate sources of income when arriving at the Assessable Income from business.

- (4) Book depreciation, asset disposal and capital allowances:
Book depreciation has been added back to the accounting profit by almost all candidates. Further, the majority have correctly applied the respective rates in claiming capital allowances.
Even though some candidates have correctly calculated the assessable charges on assets disposal, but they forgot to add the same amount to the business income in arriving at the Assessable Income from business.
- (5) Disallowable expenses:
Provision for gratuity and doubtful debt, donation, entertainment expenses, and legal expenses for signing rent agreements have been added back to the accounting profit by the most of candidates.
- (6) Allowable expenses:
Training expenses, interest on holding company loan, and bad debt written off were allowed by the majority. However, some candidates have erroneously deducted those amounts from accounting profit again. More than half of candidates have not deducted gravity payment from accounting profit as it was a cash transaction, which was not recorded in the profit and loss account.
- (7) Investment income:
Interest income and rental income have been treated as investment income by many candidates. However, only few candidates have deducted the legal expense on signing rent agreement from gross rental income under investment income.
Further, considerable number of candidates has erroneously taken into account the dividend income for which WHT has been deducted as an investment income.
- (8) Qualifying payments and reliefs:
The donation made to the government (Pradeshiya Saba) has been fully claimed by the majority without a limitation.
- (9) Identification of tax rate:
Under new amendment made to the act with effect from 01.01.2023, the standard corporate tax rate is 30% all companies irrespective of the nature of the undertaking other than betting, gaming, liquor, and tobacco. This requirement has been understood by many candidates. However, certain candidates were still applying the individual slab rates to tax a company.
- (10) Identification of tax credit:
Quarterly installment payment was claimed as a tax credit by the majority.

Performance: The overall performances were good.

Question No. 09

What was tested?

Ascertainment of personal Income Tax liability for the Y/A 2022/23 of a resident individual who works as the Legal Officer in a commercial bank in Sri Lanka. The sources of income included income from employment, business, and investment.

Observations:

The question was attempted by almost all candidates, and the fundamental knowledge of candidates pertaining to the individual taxation was in a satisfactory level. The most of candidates have secured at least 60% marks allocated for the question.

(a) Employment income:

- (1) Salary and bonus are included in the employment income by the majority.
- (2) Fuel allowance and vehicle benefit that were provided by the company has been taken as part of employee benefit by many candidates.
- (3) Medical benefit that is available for full time employees on equal terms was exempted from tax by nearly half of candidates.

(b) Business income:

- (1) The salary to assistance and office expenses has been deducted from revenue by many candidates in arriving at profit from business.
- (2) Disallowing entertainment expenses and the cost of photocopier have been done by almost all candidates.
- (3) Clamming the capital allowance (5 years) on computers was in a satisfactory level.

(c) Investment income:

- (1) Treating interest on treasury bills and loan given to a friend as liable investment income were in a satisfactory level.
- (2) However, dividend declared out of dividend received and gain on disposing quoted company shares were also erroneously treated as investment by many candidates. The most of candidates were not know that those two income are exempted from tax.

(d) Common omissions, mistakes, and remarks:

- (1) Claiming donation to the government has been done by many candidates without any limitation. However, claiming sponsorship made to the Old Boys Association and donation made to the approved charity were not in a satisfactory level. Considerable number of candidates has claimed those two payments without any limitation. Those candidates were not aware that the first one cannot be claimed at all, and the second one can be claimed subject to lower of Rs.75,000/- or 1/5 of the Taxable Income.

- (2) Personal relief Rs.1,200,000/- was properly claimed by nearly half of candidates. But, some candidates have claimed Rs.3,000,000/-, which was provided before the amendment made before 01.01.2023.
- (3) The most candidates have applied the correct tax rates with the correct slabs to tax the Taxable Income. Some candidates have applied old slab rates as well.
- (4) The APIT and installment payment have been correctly claimed by the majority as tax credits.
- (5) Some candidates have not applied 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 example, qualifying payments and quarterly installments payments have been claimed prior to the Assessable Income.

Performance: The overall performances were good.

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Common Reasons for Certain Poor Performances:

- (1) Devoting too much attention on arithmetical calculation rather than fundamental principles in taxation and respective taxing laws.
- (2) Lack of awareness on relevant taxing laws and subsequent amendments to such laws.
- (3) Poor attention to read the question paper before starting to answer the questions. This resulted to forget 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 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 properly the actual requirement of each question that permits candidate to organize the answer including the format and presentation.
- (9) Illegible handwriting that created difficulties for Examiners to understand the facts of answers. Sometime answers were impossible or almost impossible to read because of being very untidy or not clear.

- (10) Lack of relevant workings for answers or workings were properly not linked with the computations, resulting Examiners were not able to grant full marks allocated for the questions.
- (11) Some candidates did not show the proper workings to support their figures, which they have arrived in the process of calculation.

Suggestions for Improvements:

- (1) Paying attention on time management before answering to 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 is 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 remind that candidates are not allowed to make unrealistic assumption to alter the given facts of the questions itself.
- (5) Focusing on basic fundamental principles of taxation rather than arithmetical accuracy of calculations.
- (6) Providing appropriate workings for each and every calculations whenever necessary and link 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 15 minutes to read the question paper fully and then start to answer questions based on the confident level of each question.