

EXAMINER'S REPORT**AA3 EXAMINATION - JULY 2019****(AA35) CORPORATE AND PERSONAL TAXATION**

Question No. 01**Part (a)****What Was Tested?**

It was required to identify the sources of income in terms of Section 4 of the Inland Revenue Act no.24 of 2017.

Observations:

Though the question has clearly mentioned the relevant law that is applicable for the answer, considerable number of candidates had provided the answer based on the Inland Revenue Act No. 10 of 2006 (old Act).

The performance for this question was at an average level.

Part (b)**What Was Tested?**

It was required to recognize three persons who can be “authorized representatives” under the new act.

Observations:

The majority of the candidates had failed to provide the correct answer; even though 9 types of persons can be categorized as authorized representatives. Most of the candidates had provided some irrelevant answers like Commissioner General of Inland Revenue and Deputy Commissioner, etc. However, few candidates had given the correct answer.

The performance for this question was not at a satisfactory level.

Question No. 02

What Was Tested?

This question tested the knowledge pertaining to the residency for the year of assessment 2018/2019 of a subsidiary of a multinational company, which was registered under Companies Act No. 7 of 2007.

Observations:

In terms of section 69 (4) of the new act, any 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.

This question was misunderstood by some candidates referring to the section 79 (1) of old Act which stipulates that:

“Where a company or a body of persons has its registered or principal office in Sri Lanka, or where the control and management of its business are exercised in Sri Lanka, such company or body of persons shall be deemed to be resident in Sri Lanka for the purposes of this Act.”

However, majority of the candidates had referred to **registered or principal office** and **control and management of its business** elements to reach the final answer and obtained full marks.

The performance for this question was at a satisfactory level.

Question No. 03

What Was Tested?

It tested the knowledge of candidates in relation to withholding tax (WHT) paid by a company (withholder) to the individual person, and another company regarding rent, consultancy fees, and service provision.

Observations:

Even though withholding tax is not a new concept in our tax law, majority of candidates had not correctly mentioned the obligation to deduct WHT on each of the payments and calculation of total WHT deducted for the month March.

The majority had stated the wrong concept that withholder has to deduct WHT if withholder is a company & this principle is not applicable in the case of individual persons.

Only few candidates had mentioned the correct answer and obtained high marks.

The performance for this question was not at a satisfactory level.

Question No. 04

What Was Tested?

The knowledge of the candidates' in relation to estimated quarterly installment payment was tested by this question.

Observations:

In terms of the new act, the correct answer must be obtained by using the following formula:

$$\frac{\text{Estimated Tax Payable – Installment Payment}}{\text{Number of Remaining Installments}}$$

Due to lack of awareness of the provisions of the new act, the majority of candidates were not able to provide correct answer. Most of the candidates had given answers based on the following grounds:

- (1) Removing installment paid from estimated tax liability but divided by four to get the value of the third installment.
- (2) Just dividing the estimated tax liability by four, thinking the requirement of the old act.

The performance for this question was not at a satisfactory level.

Question No. 05

What Was Tested?

The following elements of partnership taxation for the year of assessment 2018 / 2019 were tested by this question:

- (a) The partnership income for tax purpose.
- (b) The withholding tax payable by the partnership.
- (c) The share of partnership income of each partner.
- (d) The withholding tax credit available to each partner.

Observations:

- (1) Most of the candidates have provided the expected answer for **part (a)** of the question as it is the same in the old act and the new act.
- (2) The knowledge of candidates on disallowing the partners' salary and accounting for depreciation as well as allowing capital allowance was good and they had answered correctly.
- (3) However, the application of WHT for the partnership income had not been done by the majority of candidates due to lack of knowledge on the provisions of the new act.
- (4) A considerable number of candidates had deducted Rs.1,000,000/- as tax free allowance before applying the WHT rate 8% on partnership income, which was the provision stipulated by the old act.

- (5) The **part (c)** of the question dealt with the share of partnership income of each partner. The allocated marks were obtained by the majority because the same answer can be obtained under the old act too.
- (6) Some candidates had treated the partnership income as divisible profit and adjusted the salary paid to each partner to reach share of income of each partner.
- (7) Majority of the candidates had failed to provide the correct answer for the part (d)

The performance for this question was at an average level.

Question No. 06

Parts (a) and (b)

What Was Tested?

Part (a) & part (b) of this question required to ascertainment of the Nation Building Tax (NBT) payable for the quarter ended 31st December 2018 by a company, which is engaged basically in manufacturing of handloom products.

Observations:

In terms of the NBT Act, any person or partnership who is engaged in the business of importation, manufacturing (other than excepted articles), carrying out the wholesale or retail business, and provision of service are liable to pay tax. Furthermore, a 50% and 75% of rebates are given for wholesalers or retailers and distributors respectively. The performance of candidates could be summarized as follows:

- (1) Sale of products manufactured by the company itself was correctly recognized by most of the candidates by applying 2% tax rate thereon.
- (2) A considerable number of candidates failed to understand the difference between wholesale, retail and manufacturing turnover.
- (3) Some candidates have considered the whole value of locally purchased items when they calculated the tax.
- (4) The majority of candidates were silent about the proceeds received from sale of an old machine.
- (5) The knowledge on claiming input tax for manufacturing items was at an acceptable level.
- (6) The knowledge on claiming input tax for the locally purchased items is very poor.
- (7) Monthly payment of NBT was properly recognized by most of the candidates.
- (8) The overall understanding on input – output mechanism and filing of NBT return was at a satisfactory level.
- (9) Date of furnishing the NBT return was properly identified by the majority.

The performance for this question was at a satisfactory level.

Part (c)

What Was Tested?

The knowledge on Economic Service Charges (ESC) was tested by **part (c)** of this question.

Observations:

Most of the candidates were confident of applying 0.5% tax rate for the sale of manufactured items and sale of locally purchased items. However, treatment for disposing old machinery was not properly adjusted by the majority.

The performance of this question was at a satisfactory level.

Question No. 07

Part (a)

What Was Tested?

This question tested the knowledge on tax payable / (over paid) with regard to Value Added Tax (VAT) for the quarter ended 31st December 2018 by a company which is engaged in manufacturing bags for both local and foreign markets.

Observations:

- (1) Most of the candidates had applied 15% tax rate for the local market sales.
- (2) The candidates' knowledge on the SVAT mechanism was relatively poor. Some candidates had applied zero rate by misunderstanding that it was a direct export.
- (3) Claiming input tax on both raw material and repairs to motor vehicle used by the CEO adjustments were properly made by the majority.
- (4) Majority of the candidates had adjusted properly SVAT credit vouchers claiming tax credit.
- (5) Most of the candidates' overall knowledge was high for input VAT / Output VAT mechanism.
- (6) Most of the answers were not in an expected format except a few.

The performance for this question was at a satisfactory level.

Part (b)

What Was Tested?

The particulars to be included in a tax invoice were tested by **part (b)**.

Observations:

Majority of the candidates had not properly understood the question and they provided some irrelevant answers by mixing up with an ordinary commercial invoice.

The performance for this question was not at a satisfactory level.

Question No. 08

What Was Tested?

This question tested the basic theoretical knowledge on corporate taxation in terms of the new act as follows:

- (1) Assess the Total Assessable Income, Taxable Income, Gross Income Tax Payable and Balance Tax Payable of a resident company when there were sources of business income and investment income.
- (2) Decide the rate of income tax in a situation where the company is engaged in a business of importation and selling in the local market with a turnover of more than Rs.500 million.
- (3) Evaluate the practical aspect of applying general deduction and the main deduction (section 10 and section 11 of the new act) for the purpose of ascertaining the business profit.

Observations:

- Very few candidates did not attempt this question.
- A large number of candidates had knowledge on the provisions of the new act in relation to corporate taxation.

➤ **Computation of business income:**

- (1) Most of the candidates had made correct adjustments for provision for gratuity, accounting depreciation, penalty, foreign tour expenses, and entertainment by adding back them to profit before taxation.
- (2) Under the new Act specific provisions for bad debts are not allowed. However, some of the candidates had provided it without knowing that fact.
- (3) Majority of the students had recorded advertising expenses, bad debt written off, and advertising for recruitment as allowable expenses in arriving at business income.

➤ **Capital allowance:**

- (1) The calculation of depreciation allowances under the provisions of the new act has been considered by the majority of candidates. However, some candidates had applied rates that were used under the old act for additions of new fixed assets. Some candidates had applied new rates for all assets though new rates should be applied only for additions from 01.04.2018.
- (2) Critical adjustments like capital allowances were omitted from the calculation by few candidates.

➤ **Qualifying payments:**

A considerable number of candidates were unaware of the limitation of claiming donation to the government. They have applied various limitations such as Rs. 500,000, 75,000 or 1/5th of assessable income.

➤ **Allowable expenses:**

- (1) Losses under the new act should be claimed as an allowable expense and full loss can be claimed. However, some candidates have deducted that amount from assessable income subject to the limitation of 35%.
- (2) Some candidates had deducted allowable expenses even after computation of tax liability.
- (3) Some candidates did not have a clear idea on “allowable” and “disallowable” and how to use them in arriving at business income for tax purposes relating it to accounting profit. Hence, some candidates had deducted allowable expenses again from accounting profit.

➤ **Tax rate:**

The application of tax rate of 28% was understood by the majority. However, some candidates have applied individual slab rates such as 4% to 24% for corporate taxation.

➤ **Tax credit:**

Most of the candidates had not considered the WHT on interest. Even though some candidates had claimed, they had used different WHT rates. Tax credits for ESC payment and quarterly installments had been adjusted properly by the majority.

Workings:

Some adjustments had been made without showing proper workings. When the answer is incorrect there was no way to give marks for any correct parts of the adjustments, if there were no working.

For example, disposal gain or loss, capital allowance.

The performance for this question was at satisfactory level.

Question No. 09

What Was Tested?

This question required to compute the personal income tax for the year of assessment 2018/2019 of a resident individual who is an attorney at law by profession. The sources of income included employment income and investment income in terms of the new act.

Observations:

Few candidates have scored high marks out of 25.

➤ **Employment income:**

- (1) The full amount of salary, travelling allowance, bonus, telephone allowance, and gift had been recognized by the majority of candidates as employment income.
- (2) Contribution to EPF and ETF made by the employer were not adjusted properly by the majority of candidates.

➤ **Investment income:**

- (1) Interest on fixed deposit and dividend from a listed company had been recognized as final tax by most of the candidates. Furthermore, interest on loan given to a friend has been accounted for as investment income except few candidates.
- (2) 25% rates paid for rent was not adjusted a considerable number of candidates.

➤ **Taxable Income:**

Personal allowance of Rs.500,000/-, allowance of Rs.700,000/- for employment income and donation to government has been deducted under qualifying payments by most of the candidates.

➤ **Application of tax rates:**

Application of correct tax rates on taxable income had been correctly applied by majority of the students.

➤ **Balance tax payable:**

Adjustment for self-assessment payment and PAYE has been made by almost all the candidates.

Common mistakes observed during the evaluation process are set out below:

(i) Employment income:

- Value of the residence provided by the employer (Rs.600,000/-) was not recognized by most of the candidates.
- As per the new Act, the full amount must be taken into consideration as benefit because; Rs. 50,000 has been paid to landlord by the employer. But some of the candidates didn't consider this fact.
- Some candidates had taken into account 8% and 3% of salary as the benefit received for EPF and ETF respectively when ascertaining the employment income.

(ii) Investment income:

- Rent income had not been correctly computed by majority of candidates.
- Some candidates had taken gross rent as income from the property.

(iii) Application of tax rates:

Some candidates had used the tax table that was prescribed by the old Act to ascertain the tax liability.

The performance for this question was at an average level.

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Hints to Improve Performance:

- (1) Study well the full content 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 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. Candidates should consider the weightage of the questions according to the new syllabus.
- (5) In order to improve the 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 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 the 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.
- (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 must.
- (8) Follow the instructions given in the question paper is important.
- (9) Refer the **self-study text** and practice 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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