

**EXAMINER'S REPORT****Level III EXAMINATION - JULY 2020****(304) CORPORATE & PERSONAL TAXATION**

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

The technical knowledge on the residency rule for individual for taxation purposes in Sri Lanka for the year of assessment 2018/2019 was tested.

It was required to calculate number of days resides in Sri Lanka based on the information given in the question and decide residency status for tax purpose in Sri Lanka.

**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 wrong number of days stayed in Sri Lanka. As a result of this they have ended up with an incorrect answer of less than 183 days and have incorrectly identified the resident status. But the correct answer is 199 days and **Mr. Thomas** is a 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 01<sup>st</sup> April 2018 to 31<sup>st</sup> March 2019) 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.

**Performance: Overall performance for this question is satisfactory.**

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

- (a) The particulars to be included in a tax invoice were tested.
- (b) Due date for submitting the VAT return for the quarter ended 31<sup>st</sup> March 2019 was tested.

**Observations:**

- (a) Certain candidates had not properly understood the question and they provided some general answers by mixing up with an ordinary commercial invoice. Some have mentioned points as a tax payer.
- (b) Considerable number of candidates has mentioned the due date as 20<sup>th</sup> April 2019.

**Performance: Overall performance for this question is satisfactory.**

### **Question No. 03**

#### **What is tested?**

This question was based on the decided case "*Rajapakse 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 and Registrar of Companies on behalf of his clients.

#### **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 practise similar questions related to case law which will facilitate to present an adequate answer under examinations conditions. Candidates should understand that, 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.

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

### **Question No. 04**

#### **What is tested?**

The knowledge on Final Withholding Payments was tested by this question. It was given transactions to identify whether those are to be considered as final withholding payment or not under the Inland Revenue Act.

#### **Observations:**

Most of the candidates' answers were at an average level. But certain candidates have not understood the question properly and have provided irrelevant explanations in detail. Some of them have identified wrong basis and have ended up with an incorrect answer. 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 law relating to the recognition of final withholding payments.

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

## Question No. 05

### What is tested?

- (a) Due dates for payments of second and third quarterly installments of the year of assessment 2018/2019 was tested.
- (b) The calculation of amount of income tax to be paid as the 2<sup>nd</sup> Quarterly instalment of the year of assessment 2018/2019 was tested.
- (c) Three methods available for the Inland Revenue Department to recover taxes in default was tested.

### Observations:

- (a) Many candidates have stated only the due date without stating correct year and some have stated incorrect due dates for payment of income tax for relevant quarters. Candidates should understand that correct due dates for the payment of income tax.
- (b) In terms of the new act, the correct answer must be obtained by using the following formula:

$$\frac{\text{Estimated Tax Payable} - \text{Tax payments prior to that instalment}}{\text{Number of instalments remaining including the current instalment}}$$

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 or two to get the value of the 2<sup>nd</sup> Quarterly installment.
  - (2) Dividing the estimated tax liability by four, thinking the requirement of the old act.
- (c) Some candidates have provided ambiguous answers for this part. They should note that the methods by which the Inland Revenue Department may recover taxes in default. It includes seizure of property, recovery through Magistrate's Court, recovery out of debts, transfer of immovable property in lieu of payment and etc. It is an advisable to study the self-study text and the candidates should obtain a thorough understanding in relation to obligations and procedures relating to taxation.

**Performance: Overall performance for this question is satisfactory.**

## Question No. 06

### What is 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. However, most of the candidates have added rent income when calculating partnership income. They have not understand that it is a business income.
- (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) Some 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.
- (4) Some candidates have not applied the correct withholding tax rate of 8%, instead they have applied 10%, 14% and 28%, etc.
- (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)**.

**Performance: Overall performance for this question is satisfactory.**

**Question No. 07****What is 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 hats, hand bags etc. for both local and foreign markets.

**Observations:**

- (1) As per the provisions of the Value Added Tax Act, export sales are taxable at zero rate. Which means, VAT liability on export sales are Zero (Nil). But, most of the candidates have recognized export sales as exempt supply and not calculated output tax payable on the same. Some candidates have charged tax for the same.
- (2) Most of candidates did not calculate output VAT on sales proceed on fixed asset.
- (3) Candidates who have considered exports sales as exempt supply have not claimed input tax attributable for packing materials exclusively used for exports.
- (4) Claiming input tax on packing materials exclusively used for exports, office expenses, repair of machine used in production and repairs to motor vehicle used by the managing director adjustments were properly made by the majority.
- (5) Most of the candidates have not stated the proper calculation to identify maximum claimable input tax against the output tax with the relevant conditions as stated in the Value Added Tax Act.
- (6) Most of the candidates' overall knowledge was good for input VAT / Output VAT mechanism.

**Performance: Overall performance for this question is satisfactory.**

## Question No. 08

### What is tested?

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

- (1) Assess the 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 importing ready-made garments and selling those in the wholesale 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:

- (1) Very few candidates did not attempt this question.
- (2) 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 accounting depreciation, donation, legal expenses, provision for gratuity, entertainment expenses and general provision made for trade debtors by adding back them to profit before taxation.
- (2) Some of the candidates had not recognize tax treatment properly for the bad debt written off to the income statement. Under the new Act bad debt written off to the income statement is allowed for the income tax purpose.
- (3) Majority of the students had recorded bad debt written off and foreign travelling cost incurred as allowable expenses correctly in arriving at business income.

### ❖ Capital allowance:

- (1) The calculation of capital 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 after 01<sup>st</sup> April 2018. Few candidates have omitted to calculate the capital allowance.
- (2) Though the land is not entitled for the capital allowances, some candidates have computed capital allowances for the land as well.
- (3) Considerable number of candidates has adjusted in balancing allowance on furniture disposal during the year.

❖ **Investment income:**

Correct recognition of rent income on land was not performed by majority.

❖ **Qualifying payments:**

A considerable number of candidates were unaware of the limitation of claiming donation to an approved charitable institution established for the provision of institutionalized care for the sick or the needy. They have applied various limitations such as Rs.75,000/- or 1/5th of assessable income. As per question, it was limited to Rs.500,000/-.

❖ **Allowable expenses:**

- (1) Brought forward tax 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 and some applied 14%.

❖ **Tax credit:**

- (1) Most of the candidates had not considered the WHT on rent income.
- (2) 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.

**Performance: Overall performance for this question is satisfactory.**

## Question No. 09

### What is tested?

This question required to compute the personal income tax for the year of assessment 2018/2019 of a resident individual who is a chartered accountant attached to a commercial bank. The sources of income included employment income, investment income and business income in terms of the new act.

### Observations:

Majority of candidates had knowledge on the provisions of the new act in relation to personal taxation.

#### ❖ **Employment income:**

The full amount of salary, travelling allowance, life insurance premium and family tour cost reimbursed had been recognized by the majority of candidates.

#### ❖ **Investment income:**

- (1) Interest on fixed deposits had been properly recognized as final tax by most of the candidates. Furthermore, interest on treasury bills was also recognized as investment income.
- (2) Correct recognition of capital gain on land sold was not performed by majority. Considerable number of candidates have not taxed the same at the rate of 10% when calculating gross tax payable.
- (3) 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 have 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:**

(1) Employment income:

Value of the travelling benefit provided by the employer was not recognized by most of the candidates.

(2) Investment income:

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

(3) Application of tax rates:

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

**Performance: *Overall performance for this question is satisfactory.***

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**Hints to improve performance:**

- (1) Time allocation must be considered before start answering questions.
- (2) Summarizing answers as much as possible depending on the requirement of the question and marks allocated.
- (3) Answering the past question papers and check with model answers to improve the examination skills and answering speed before sitting for the examination.
- (4) Focusing on basic fundamental principles of taxation with arithmetical accuracy of calculations.
- (5) Making clear and realistic assumptions that need to answer questions.
- (6) Answering the question paper with legible handwriting that will enable the marking examiner to understand the facts.
- (7) Providing appropriate workings for each and every calculations if necessary and link them with the answers.

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