



Examiners' report

F6 Taxation (PKN)

June 2008

This examination was the second sitting in the new syllabus. The paper consisted of five compulsory questions with an approximate 3:1 split requirement for computation and narrative respectively.

There were some very good performances across the paper and excellent answers were presented by a fair number of candidates, some scoring high marks. The performance of candidates overall was not to the required standard with a large number appearing to be unprepared for the examination.

The computational questions were better answered than questions, or parts thereof, which required narrative answers. More marks could have been earned in the computational questions if, as clearly stated in the requirements, candidates had given clear reasons / explanations for the inclusion or exclusion in the computation of taxable income of each of the items listed in the scenario of the questions. The reasons / explanations, even when given, were in most cases superficial and vague resulting in candidates being unable to communicate to the markers a clear justification for the treatment given in the context. Furthermore, very few candidates gave any explanation as to why a particular item was not included in the computation of income, despite the fact that the question clearly indicated that specific marks were allocated for this part of the answer.

It was noted that many candidates continue to present their answers poorly with a lack of clear labelling to indicate which question was being attempted, not ticking the appropriate box of the question attempted on the cover sheet of the answer paper and not following the instruction of starting each question on a new page.

The standard of writing legibility was fair, however there was considerable room for improvement in the following areas:

- language – words used should be simple, clear and precise to express what is meant to be conveyed
- layout, structuring and organisation in computational answers – candidates must give more thought to the layout and organisation of their answers to arrive at the required result with the least amount of confusion and wastage of time
- time management – remarks awarded to a question should serve as a guide of how much the answer is to be elaborated. Candidates not planning answers according to the marks allocated put themselves under time pressure
- workings – give comprehensive and clear workings as it enables markers to give credit for partially correct answers and thereby maximise marks
- depreciation claimed – aim to present the workings in a format similar to that given in the answers of past examination papers.

For the next examination I will continue to test a wide coverage of the syllabus. Therefore it is imperative that candidates avoid selective study, ensure that their preparation involves a broad coverage of the syllabus and closely follow the study guide with attention to the key areas of the syllabus.

Other suggestions:

- use the past examination papers during preparation of the exam and as a revisional aid
- read carefully the examiner's feedback on past examination papers
- read carefully the requirement portion of the question to understand what is required
- use short sentences when answering the requirements of a question thereby ensuring good time management
- use the style of expanded bullet points when pressed for time unless the question requires a particular format

- give more thought to the layout and structuring of the answers especially in the computational questions with emphasis on giving clear explanations for the inclusions or exclusions of each of the items given in the scenario to the question
- give comprehensive workings in all computational questions.

Question 1

This 30 – mark question focused on taxation of a corporate entity. Part (a) of the question tested candidates' understanding of the definition of a public company and the concept of residential status of a company. This part was worth 3 marks and it should have been apparent that a simple and direct approach was required. Instead many answers contained much extraneous material, which put candidates under time-pressure.

Parts (b) and (c) of the question on the computation of income and calculation of tax respectively were frequently well answered with some candidates scoring high marks. Poor presentation in the layout and organisation of the computation of income was a problem in many scripts. The other common failure was that the explanations given for the treatment of items included in the computation of income were not to the required standard, seemingly due to a lack of understanding of the principles involved. The majority of candidates, even those securing pass marks, gave no explanations for items which were not included in the computation of income. More marks could have been earned if attention had been directed to this very important requirement.

Many did not pick up from the scenarios that the new computer software – an intangible for tax purposes – purchased during the tax year 2008 was not utilised in the business of PQR (Pakistan) Ltd (PQR) until after the end of the said tax year. An amortisation deduction is allowed for an intangible but only if it is used in the tax year in deriving income from business chargeable to tax. As the software was not used in PQR's business in the tax year 2008, there can be no claim for an amortisation deduction.

Common errors included one or more of the following:

- failing to treat as inadmissible expenditure:
 - legal expenses paid for increasing the share capital
 - tax collected by the Collector of Customs on the import of raw materials for own use and on imported injections in finished form, for sale
- failing to present the tax depreciation workings in an organised format
- failing to claim a tax credit on the tax paid by the AOP or if the tax credit was claimed, the amount was incorrectly calculated
- treating the excess amount of provision for bad debts written back as taxable income
- treating the lease rent paid to an approved leasing company for the lease of a liquid filling plant as an inadmissible expenditure
- claiming as a deductible charge the amount paid to Workers' Welfare Fund in computing the total income instead of as a deductible allowance from the total income to arrive at the taxable income.

Question 2

This 25 – mark question was on the subject of taxation of an individual (Mr. Qureshi) having income from diverse sources. Besides testing the tax implication of some elements of salary income such as pension, un-availed privileged leave, gratuity, compensation for change in employment terms and the provision of an employer owned apartment at concessional rent with free electricity, the question also tested the tax implications of:

- income from the rendering of services;
- rent received by Qureshi as consideration for the use of the land owned by him;
- receipt of a refundable deposit but not adjustable against the aforesaid rent;
- forfeited deposit under a contract for sale of the land; and

- income taxable under the final tax regime.

It was pleasing to note that there were some good performances in the computation of salary income. There were also some poor scripts which was disappointing since many of the areas tested had been examined previously.

The monthly allowances for housing, utilities and medical for June 2008, collected by Qureshi from Superior Steel Ltd (SSL) on 7 July 2008, were not included in Qureshi salary income on the erroneous reasoning that the allowances were not received in the accounting year ended 30 June 2008. Candidates did not appear to be aware that a person is treated as having received an amount, benefit or perquisite if it is made available to the person. As all employees of SSL were required to collect the allowances on the last working day of each month, the allowances for June 2008 though collected by Qureshi from SSL on 7 July 2008, were made available to Qureshi in June 2008 and was therefore his salary income for the year ended 30 June 2008.

Many candidates did not pick up from the scenario that the gratuity scheme of XYZ Private Ltd (XYZ) was approved by the then Central Board of Revenue and was applicable to all employees of XYZ. Therefore the amount of gratuity exempt from tax is Rs. 200,000 and not Rs. 75,000 as claimed by most candidates.

The computation of income from business was poorly attempted. Most candidates were not aware that:

- the tax deducted by Rose Pakistan Ltd (RPL) from the fees paid to Qureshi is treated as the final tax of Qureshi on the income from the fees received
- that the income chargeable to tax under the head income from business would arise only from the fees received from individuals
- out of the common expenditure of Rs. 88,432 incurred in deriving fees from RPL and from the work done by individuals, only the portion allocable to the fees received from individuals is deductible.

As in question-1, the explanations given for the treatment of items included in the computation of income were superficial and vague and in most cases, no explanations were given for items not included in the computation.

Other common errors:

- not treating concessional rent for use of company's apartment and free electricity provided by the employer as a taxable perquisite
- claiming exemption of medical allowance up to 10 per cent of basic salary when Qureshi's terms of employment provided for reimbursement for all medical treatment or hospitalisation charges
- not treating the forfeited deposit paid under a contract for the sale of land as income from property
- claiming as a deductible charge the amount paid for zakat in computing total income instead of as a deductible allowance from the total income to arrive at the taxable income
- erroneous calculation of tax credit on donation.

Question 3

This computational question worth 20 – marks was primarily on the subject of capital gains. There were few good scripts but overall the standard should have been better considering that the subject of capital gains covers only a few sections of the tax statute and the law is common for corporate and unincorporated taxpayers. Furthermore, the concepts tested had been dealt with in the past examinations and it was obvious that enough attention was not paid to the previous solved exam papers.

A significant number of candidates were unable to correctly compute the gain on the sale of shares in Safe Bank Inc acquired under an employee share scheme. In calculating the gain on the disposal of the shares, most candidates did not include in the cost of the shares, the amount charged to tax at the time of acquisition of the shares. There were also some candidates who did not appear to be familiar with the non-recognition rules whereby no gain or loss is taken to have arisen on the disposal of an asset, *inter alia*, by reason of a gift of the asset provided the person acquiring the asset is not a non-resident at the time of the acquisition of the asset.

Other common errors included:

- gain on the disposal of one share in Karachi Stock Exchange (Guarantee) Ltd not claimed as exempt from tax
- gain on the disposal of shares in Aromatic Coffee (Pakistan) Ltd, a public company for tax purposes, not claimed as exempt from tax
- loss on sale of shares in Alibaba Ltd, a company listed on the Lahore Stock Exchange, claimed as a deduction
- loss on the disposal of the painting claimed as a deduction
- tax credit on the purchase of new shares in NewCo Ltd erroneously calculated
- explanations / reasons given for the treatment of items included or excluded in the computation of income were superficial and vague.

Question 4

This wholly narrative question worth 15 – marks proved to be the least well answered question on the paper. The question sought to test certain basic concepts relating to the provisions of advance tax applicable to a company, payment for termination of a contract for purchase of new machinery, settlement of a forward contract for purchase of raw materials by a payment instead of taking delivery of the raw materials, repairs – whether capital or revenue and the acquisition of a valuable trade mark.

Well prepared candidates were able to score very high marks but most answers were below the pass standard due to a general lack of understanding of the principles involved. There were some reasonable answers on the issues of the payment made for the termination of the contract for purchase of machinery and the acquisition of the trade mark. Generally adequate reasons were not furnished to substantiate the answers.

Few candidates were aware that:

- Sunflowers Oil Pakistan Ltd (SOPL), being a company, was required to pay advance tax even if it had not been charged to tax previously
- a contract entered in the course of a manufacturing business to guard against future price fluctuations is in the nature of a hedging contract. Such contracts have been excluded from the definition of speculative business. Therefore the payment of Rs. 950,000 is a deductible charge being in the normal course of the business of SOPL
- the expenditure of Rs. 790,000 incurred on the labelling machine, though in the nature of repairs, is capital expenditure since SOPL at the time of purchase of the machine was aware that the machine was in an imperfect condition and the repairs were necessary to bring the machine to a proper standard for use before it could be used in the business.

Question 5

This 10 – mark question was on the subject of sales tax.

Part (a) dealt with a situation where there is a change in the rate of sales tax during a tax period. The scenario assumed that the rate of sales tax was reduced from 15% to 12% effective 16 October 2007. Candidates were required to state the manner in which the sales tax return for the month of October 2007 would need to be furnished and also calculate the sales tax payable for the month of October 2007. This part of the question was generally well answered. Some candidates were not aware that no input tax could be claimed on the purchase of spare parts and supplies since the payment was made in cash.

Part (b) was a small narrative question which was well answered. Candidates were required to state the period for which a person is required to retain records and documents under the Sales Tax Act.