

Examiner's report

F6 Taxation (PKN)

June 2009



General Comments

The examination consisted of five compulsory questions with a 85:15 split requirement for computational and narrative questions respectively. Most candidates attempted all five questions.

It was pleasing to note that overall there was an improvement in the quality of the answers. There were some very good performances with candidates gaining high marks. There were also poor scripts which seemed to indicate that a portion of the candidates appeared unprepared for the examination. Question 1, the computational question, on corporate taxation was frequently the best answered question while Question 4, a wholly narrative question, was generally not well answered.

The computational questions 1, 2 and 3 explicitly required candidates to give clear reasons / explanations for the inclusion or exclusion in the computation of income of each of the items listed in the scenario of the questions. The emphasis on giving reasons and explanations was to highlight to candidates the necessity to clearly explain why the items listed in the scenario were to be included or excluded in the computation of income. Though there was improvement in this area, the explanations / reasons given in a large number of scripts were vague resulting in candidates being unable to communicate to the markers a clear justification for the treatment given in the context. Many candidates gave no explanations / reasons for items excluded in the computation despite the fact that the examiner's feedback on past exams had highlighted this weakness. Tutors and candidates need to be aware that important marks are assigned to this part of the requirement in the questions. Another common error in the computational questions was that different sources of income were not shown under the appropriate heads of income, despite that this was specifically asked for in the requirements of questions.

The standard of writing legibility was generally fair. However in the narrative parts there is need for improvement in the language. Though there is no negative marking for poor grammar and spellings, the language should be simple, clear and precise conveying the candidates' point of view.

Tutors and candidates should also focus on the following areas:

- organised layout in computational questions – a columnar layout for computations help in arriving at the required result with the least confusion and wastage of time. Use the layout similar to that given in the answers of past exam papers and give clear explanations for the inclusion or exclusion in the computation of income of each of the items given in the scenario to the question
- explanation in computational questions – to be clearly labelled
- taxable income or loss to be shown under the appropriate heads of income
- workings – should be clear and comprehensive. Absence of clear workings prevent markers from giving marks for partially correct answers
- presentation – candidates must follow the ACCA instruction of ticking the appropriate box for each question answered on the cover sheet of the answer paper and starting each question at the top of a new page with clear labelling to identify which question or part of a question is being answered
- time management – marks awarded to a question or a part of a question give an indication of the time to be spent on the question. Candidates not planning answers according to the marks allocated put themselves under time pressure

Candidates sitting future exams are advised to:

- avoid selective study and prepare across the whole syllabus

- use the syllabus and study guide as the basis of learning
- develop computational and discursive skills
- use past examination papers during preparation for the exam and as an aid for revision
- read carefully the requirement portion of the question to understand what is required
- use short simple sentences. Use the style of expanded bullet points only when pressed for time

Specific Comments

Question One

This 30 marks question focused on testing candidates' ability to deal with varied aspects relating to the computation of taxable income of Awami Cars Ltd (ACL) a company in the business of sales of motor cars and operating a workshop for motor car repairs and maintenance. The question was generally answered to a good standard and many candidates scored high marks. More marks could have been earned had the candidates given clear explanations for the inclusion or exclusion in the computation of income of each of the items listed in the scenario of the question.

Common errors committed by candidates who failed to score high marks:

- failing to treat as admissible expenditure
- Rs. 37,000 stamp and registration charges for entering into an agreement with a bank for overdraft facilities
- Rs. 300,000 paid to Mr. A for an out-of-court settlement against claim for damages sustained to his motor car due to negligence of ACL's employee
 - loss on exchange of Rs. 280,000 on payment of final instalment of a foreign currency loan utilised for the import of a unit of plant. Though correctly treated as inadmissible, Rs. 280,000 was not added to the written down value of the plant for depreciation purposes
 - failing to treat as inadmissible expenditure the payment of Rs. 250,000 for advertisement services to the non-resident Wireless Operators Dubai for non-deduction of tax under s.153A
 - erroneous calculation of tax loss on a motor car gifted by ACL to a retiring director
 - Rs. 75,000 credited to provision for bad debts not treated as taxable income. The Rs. 75,000 is chargeable to tax since it represents a recoupment of loss previously written off and allowed as a deduction (s.70)

Question Two

This computational question worth 25 marks question was on the subject of taxation of an individual Mr. Mohsin having income chargeable to tax under the income heads of 'Salary', 'Income from business' and 'Income from other sources'. Overall there were many poor scripts, which was disappointing since most of the topics have been examined previously.

More marks could have been earned had the candidates given clear explanations for the treatment of items included or excluded in the computation of income of each of the items listed in the scenario of the question.

In the computation of income under the head 'Salary' most candidates were unable to justify their conclusion of treating Rs. 150,000 paid by JMC Medical Centre to the Poor Patients Unit, as Mohsin's salary income chargeable to tax. Candidates should have clearly stated that Mohsin is treated as having received the Rs.

150,000 since, as instructed by him, the Rs. 150,000 was paid on his behalf to the Poor Patients Unit. Other common errors in the computation of salary income included:

- medical allowance erroneously claimed as exempt. The allowance was taxable since Mohsin under the terms of employment was entitled for free medical treatment
- Rs. 120,000 received from the JMC Employees Provident Fund representing the employer's contribution to the Fund not taken as Mohsin's salary income. Candidates did not pick up from the scenario that since the fund was not recognised by the Commissioner and no tax was deducted, the Rs. 120,000 is chargeable to tax

The computation under the head 'Income from business' was poorly attempted. Many candidates did not pick up from the scenario that:

- Rs. 360,000 tax deducted by corporate clients from payment of the gross fees of Rs. 6,000,000 is the final tax; and
- since one-half of the bungalow housing the clinic was used by Mohsin for his residence, only 50% of the rent paid for the bungalow is business expenditure.

Surprisingly few candidates were aware that in arriving at the taxable income of the clinic, the total expenditure of the clinic and depreciation was required to be allocated in the proportion the fees received from individuals bears to the total gross fees received.

Other common errors included:

- US\$ 5,075 received by Mohsin as a gift erroneously treated as taxable income
- not showing the different sources of income under the appropriate heads of income

Question Three

This computational question worth 20 marks, primarily on the subject of capital gains, was generally well answered. There were some excellent scripts but overall the standard could 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. Candidates who were unable to secure pass marks demonstrated a general lack of understanding of the principles involved resulting in poor marks. As similar topics have been examined in the past, it was apparent that candidates continue not to use the past papers in their preparation for the exam and as a revision aid.

A significant number of candidates were unaware that the gain on the transfer of shares of a stock exchange in Pakistan by an individual to a company is no longer exempt from tax. This exemption was available for transfers effected between 1 July 2005 up to 30 June 2008. The Finance Act, 2008 did not extend the exemption.

It is encouraging to note that most candidates now appear to be familiar with the non-recognition rules (s.79) and the basis of computation of capital gains on the disposal of shares acquired under employee share schemes.

Question Four

This question worth 15 marks was the least well-answered question on the paper. The question, primarily narrative, sought to test candidates' knowledge of the following concepts of tax law relating to Rafiq Industries Ltd (RIL), a small company for tax purposes, for the tax year 2009:

- deduction of tax by RIL on payments for the sale of goods;
- Rs. 1,780,000 payable for repairs to an item of plant in the tax year 2008 but kept in suspense and sought to be claimed in the tax year 2009 when the amount was paid;
- minimum tax;
- calculation of capital gains on sale of shares which included bonus shares received in the tax year 2009; and
- tax treatment of the value of the bonus shares received.

Most answers were well below the pass standard indicating that candidates understanding of basic tax concepts and its application to practical cases were very weak. There appeared to be a general aversion to narrative questions.

Many candidates were able to correctly work out the capital gains on the sale of shares. Very few candidates were aware that a small company for the tax year 2009 was required to withhold tax, *inter alia*, on payments for the sale of goods. This provision was enacted by the Finance Act, 2008 (applicable from 1 July 2008). The majority of candidates were also not aware that-

- the provision relating to payment of minimum tax was deleted by the Finance Act, 2008 and therefore no minimum tax was payable for the tax year 2009
- RIL being a company has to account for business income on accrual basis. Under the accrual basis accounting deductions are allowable only for expenditure incurred in the relevant accounting year. Rs. 1,780,000 for repairs to the item of plant was payable by RIL in the tax year 2008 and is therefore not deductible in the tax year 2009 when the amount was actually paid
- the face value of the bonus shares received by RIL is not income chargeable to tax since the definition of 'income' under the Income Tax Ordinance specifically excludes from its ambit, the face value of any bonus shares issued by a company to a shareholder

Question Five

This question worth ten marks was on the subject of sales tax requiring candidates to calculate sales tax payable or refundable for the month of October 2008. The question focused on the tax treatment to be accorded to:

- input tax on purchase of raw materials for manufacturing taxable supplies and exempt supplies;
- input tax not claimed in the return of September 2008; and
- purchase of items given as gifts to customers.

Very high marks were achieved by some candidates but considering that the question involved only straightforward basic concepts, the results could have been better. The concept of apportionment of input tax on purchases of raw materials for manufacturing taxable supplies and exempt supplies was not well answered by many candidates.