



Examiners' report

F6 Taxation (PKN)

December 2008

The examination was the third sitting in the new syllabus. There has been no change in the format of the paper and all five questions were compulsory. The split between the computation and narrative was 76:24 respectively.

There were some good performances across the paper and a few candidates gaining high marks. Although the examination has continued to follow the same style of questions, the performance of the candidates overall continued to disappoint which seemingly was due to inadequate preparation of the examination and failure to carefully read the requirements of the questions.

The computational questions 1, 2 and 3 specifically required candidates to give clear reasons/explanations for the inclusion or exclusion, in the computation of taxable income, of each of the items listed in the scenarios of the questions. Tutors and candidates need to be aware that though important marks were assigned to this part of the questions, the reasons and explanations given in a large number of scripts were superficial and vague resulting in candidates being unable to communicate to the markers a clear justification for the treatment given in the context. Most candidates gave no reasons or explanations as to why a particular item was not included in the computation of income, despite the fact that specific reference was made to this requirement by indicating that the reasons/explanations for the items not included in the computation of income should be shown separately from the other reasons/explanations. Examiner's feedbacks on past exams had highlighted these weaknesses but candidates continue to ignore this essential part of the requirement and lose valuable marks.

The standard of writing legibility was generally fair, but there is room for improvement in the following areas:

- 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.
- language – to be simple, clear and precise following the requirement verb in the question
- 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 of the question
- workings – should be clear and comprehensive – absence of clear workings prevent markers from giving marks for partially correct answers
- depreciation schedule – it is essential to present workings in the format similar to that given in the answers of past exam papers
- 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 for 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.

Question 1

This 30-mark question tested candidates' ability to prepare a computation of taxable income of a company and calculate the tax payable or refundable. Part (a) of the question required candidates to state whether or not Woodcrafts Pakistan Limited (WPI) is a public company for tax purposes. Some answers contained much extraneous material given that the part was worth only 2 marks. Though similar questions focusing on the definition of public company for tax purposes have featured in past exams, many candidates failed to pick up from the scenario that even if 50% of the shares in WPI were held by a foreign company, the foreign company was not wholly owned by a foreign government and therefore WPI was not a public company for tax purposes.

The computational parts of the question were answered to a good standard. Further marks could have been earned with clear explanations for the inclusion or exclusion in the computation of income, of each of the items given in the scenario of the question. Far too many candidates were not aware of the provisions of group relief and were unable to comment on WPI's proposal to claim as a deduction Rs. 875,000 surrendered by Stylecrafts (Private) Ltd., a subsidiary of WPI. Also no reasons or explanations were given for treating as a taxable receipt, Rs. 1,000,000 received from a supplier who failed to deliver a consignment of wood within the time stipulated in the supply contract.

Other common errors included:

- calculating tax profit on sale of a motor car without considering that the cost of the motor car had been restricted for claiming tax depreciation
- failing to show tax depreciation workings in an organised format
- failing to treat as inadmissible deduction:
 - Rs. 220,000 for legal costs incurred for the purpose of standing as a surety for due performance of a supply contract undertaken by WPI's 100% subsidiary. As the subsidiary is a separate legal entity, Rs. 220,000 is not deductible as it is not expenditure for the purpose of WPI's business
 - Rs. 49,000 paid to the consultant in the matter of increasing the company's share capital. The expenditure is capital in nature and is therefore not deductible.
- the gain on disposal of shares in the subsidiary company erroneously shown under the income head 'Income from business' instead of as 'Capital gains'.

Question 2

This 25 marks question was on the subject of taxation of an individual Mr. Abdullah having income chargeable to tax under the income head of 'Salary', 'Income from property', and 'Income from other sources'.

Again, the explanations given for the treatment of items not included in the computation of income were superficial and vague and in almost all cases no explanations were given for items not included in the computation of income.

Most candidates ignored the issue of the salary income of Abdullah from Lotus Associates Dubai. Tuition providers should note that the candidates did not appear to be aware that if a citizen of Pakistan leaves Pakistan during a tax year and remains abroad during that tax year, any salary income earned by the individual outside Pakistan during that tax year is exempt from tax.

Many candidates did not pick up from the scenario:

- that the aggregate amount of Rs. 1,850,000 for salary, gratuity and compensation for redundancy of employment due from ABC Inc for the year ended 30 June 2007 was chargeable to tax in the tax year 2008 since the amount was received by Abdullah on 2 July 2007 – the date when the Rs. 1,850,000 was credited to his bank account

- that Abdullah had elected for the Rs. 800,000 received as compensation for redundancy of employment from ABC Inc, to be taxed at the average rate of tax of the preceding three years. This resulted in an error in the calculation of the tax payable

Other common errors:

- Rs. 200,000 was erroneously claimed as exempt from tax out of Rs. 750,000 received as gratuity. As gratuity received was neither from an approved gratuity fund nor under an approved gratuity scheme applicable to all employees, the amount exempt from tax is 50% of the amount received or Rs. 75,000 whichever is the lower
- Rs. 3,000,000 received by Abdullah from Mr. Bee as a deposit against the sub-lease of the factory building taken on rent by Abdullah, was erroneously treated as rent chargeable to tax in 10 equal instalments. As Abdullah was not the owner of the factory building, no portion of the deposit of Rs. 3,000,000 is chargeable to tax
- the special allowance of Rs. 20,000 per month received by Abdullah from PQR Ltd to meet entertainment expenses wholly and necessarily to be incurred in the performance of his duties as a finance manager was erroneously claimed as exempt from tax. The exemption from tax is not available when such special allowance is an entertainment or conveyance allowance
- the profit free loan from the employer was not treated as a taxable perquisite or when treated as a perquisite, the taxable value of the perquisite was wrongly calculated

Question 3

This computational question worth 20 marks was on the subject of capital gains. There were some good scripts but overall the results should have been better considering that the provisions relating to capital gains under the Pakistan tax statute are neither numerous nor complicated and are common to companies, individuals and other unincorporated bodies.

Parts (a) and (b) worth 3 marks each were narrative questions on the chargeability to tax of gains on the disposal of shares by non-residents where the sale transaction was completed outside Pakistan and the sale consideration was also realised outside Pakistan.

In Part (a), Chin Inc, a non-resident company, made a gain of US\$ 75,000 on the disposal of shares in a company incorporated in Pakistan to a tax resident of the United Kingdom. There were many good answers and candidates were aware that any gain on the disposal of shares in a resident company is a Pakistan-source income and therefore the gain of US\$ 75,000 is chargeable to tax as capital gains.

In Part (b), Mr. Prospector (P), a non-resident disposed of his shares in Black Gold Inc (BGI), a non-resident company, operating in Pakistan as a branch. At the time of the disposal of the shares, BGI was engaged in the business of oil exploration in Pakistan and its principal asset in Pakistan was the right, grant by the Government of Pakistan, to explore for or exploit natural resources in Pakistan. It was apparent that few candidates were aware that since the principal asset of BGI in Pakistan was the right to explore for and exploit crude oil in Pakistan, the gain of US \$ 2,500,000 on the disposal of the shares in BGI is the Pakistan-source income of P and therefore the gain is chargeable to tax in Pakistan as capital gains.

Part (c) required candidates to compute the taxable income and tax liability of the late Mrs. Moneybags (M). The question focused on the tax implications to M on the transmission of her assets to her three daughters in accordance with her last will and testament.

Many candidates lacked an understanding of the non-recognition rules under which no gain or loss is taken to arise under certain modes of disposal of a capital asset provided the person acquiring the asset is not a non-resident person at the time of the acquisition. A disposal of an asset by reason of the transmission of the asset to a beneficiary on the death of a person falls under the non-recognition rules. The topic of non-recognition rules has featured in almost all previous exams and it was obvious that enough attention is not paid to past exam papers.

Common errors included:

- the gain on the conversion of US\$ 40,000 into Pakistan rupees was not recognised as a capital gain
- not recognising that the unadjusted loss of Rs. 768,640 on account of forward trading in the purchase of cotton was a speculative loss which can only be set off against the income of any speculative business of the person
- not recognising that the unadjusted capital loss of Rs. 345,000 sustained in the accounting year ended 30 June 2001 lapsed on 30 June 2007 (tax year 2007) and was therefore not available for set off against capital gains in the tax year 2008
- not recognising that the transmission of Rs. 3,419,017 to Ginnie had no impact on the computation of income since there can be no gain or loss on the transfer of Pakistan rupees.

Question 4

This wholly narrative question was the least well answered question on the paper. The question sought to test candidates' knowledge of five concepts of the tax law relating to:

- deduction of tax from a payment for royalty to a non-resident;
- persons required to deduct tax on a payment for the rendering of services;
- the taxation of income derived from a business which had ceased to exist;
- the allowability of salary paid in cash; and
- the limitation of an exemption of tax.

Some candidates obtained very high marks as the issues related to basic concepts of the tax law. However, most answers were well below the pass standard indicating that candidates' understanding of the law and its application to practical cases was generally very weak. The poor results could also be attributed to a general aversion to questions requiring narrative answers.

Many candidates had little idea of the provisions relating to income derived by a person in a tax year from a source of income that ceased before the commencement of the said tax year. Consequently candidates failed to recognise that the Rs. 40,000 received by Chaiwalla from Ali Canteen Stores in the tax year 2007, though relating to his coffee house business that ceased on 31 December 2002, is considered to be Chaiwalla's taxable income derived in the tax year 2007. This is because the provisions of the tax statute apply to such income as if the business of the coffee house had not ceased at the time the income was derived.

Most candidates were also not aware that:

- the payment of Rs. 150,000 to the non-resident Doodpati Inc (DI) for royalty is a Pakistan-source income of DI and therefore tax was required to be deducted at source from the payment made to DI
- Mr. Chaiwalla being an individual is not a 'prescribed person' under the tax statute and was therefore not required to deduct tax from the payment of Rs. 50,000 to Mr. Consultant for providing services in connection with cost – cutting measures in Chaiwalla's business

- the benefit of exemption from tax of any income is limited to the original recipient of the exempt income and does not extend to any other person receiving a payment out of the exempt income. The Rs. 36,000 received by Chaiwala as a dividend out of the exempt income of Orchids Farms Limited is therefore chargeable to tax.

Question 5

This question was on the subject of sales tax. Part (a) required candidates to calculate the sales tax payable by a registered person focusing on the limitation imposed on the claim of input tax up to 90% of the output tax for the tax period and also the treatment of input tax paid on the purchase of machinery for a new manufacturing unit. Candidates were required to give clear explanations for the treatment accorded to the determination of input tax on the above items. Many candidates lacked knowledge in respect of the treatment to be accorded to the above items in determining input tax and consequently failed to gain easy marks.

Part (b) worth 3 marks was narrative relating to the timing of issue of credit notes. This part was frequently well answered.