



# Examiner's report

## F6 Taxation (PKN)

December 2014

### General Comments

The examination paper consisted of five compulsory questions. Question one dealt with income tax affairs of a company (30 marks) and Question two the income tax affairs of an individual (25 marks). Question three, (20 marks) related to the computation of capital gains and the tax thereon. Question four (15 marks) dealt with tax obligations of the taxpayers and consequences in the case of their non-fulfillment. Question five (10 marks) was set on sales tax.

Many candidates attempted all five questions demonstrating an ability to prepare for core areas of the syllabus and achieved good marks. A few scripts were very impressive. Overall there was no evidence of time pressure. Where questions were left unanswered by a candidate, they often fell short of the pass mark and this seemed to be due to a lack of knowledge of the subject. Analysis of those scripts that did not pass indicated that full questions had not been attempted.

Note: The candidates sitting for June & December 2015 sessions are:

- (i) advised to consult syllabus guide carefully as patterns of the question paper and marks allocated to different areas of the syllabus has been changed.
- (ii) expected to know and apply amendments brought about in the Finance Act, 2014 insofar they relate to the syllabus areas.

### Specific Comments

#### Question One

Question one was about the income tax liability of a public listed company. This question was very well attempted by most of the candidates.

A few common mistakes found in different scripts are discussed below:

#### Part (a)

Computation of taxable income

##### (i) Donation to mosque

A donation paid to a mosque is not an admissible expenditure as it was not wholly and exclusively for the purposes of business. [s.20(1)] Further, it was not eligible for tax credit as a mosque was not an approved institution for the purposes of section 61 of the Income Tax Ordinance, 2001.

##### (ii) Loan to an ex-employee – written off

A few candidates treated this amount as an admissible deduction. However, since the amount of the loan was not included earlier in the income, it is not allowable as a deduction under the law. [s.29(1)(a)(i)]

(iii) **Charges for installation of laboratory equipment**

Charges incurred for the installation of new laboratory equipment were capital in nature and were to be treated as part of the cost of the assets and not allowable as revenue expenditure. However, they were eligible for tax depreciation and initial allowance. Some candidates incorrectly treated them as revenue expenditure. [s.76 read with s. 22 and 23] Capitalisation of expenditures is often examined and needs more attention paid to it by candidates.

(iv) **Car given to a dealer under a sales promotion scheme**

The taxpayer was required to collect tax on the fair market value of the car [s.156(2)]. Non-withholding of tax on this account will attract certain adverse consequences under the law like recovery of tax not deducted from the dealer if the dealer had not paid tax himself, etc. However, the expenditure incurred on a prize for sales promotion does not become inadmissible for default of non-deduction of tax. [s.21(c)] Some candidates did not realise this and incorrectly disallowed this valid expenditure.

(v) **Profit paid for funds taken to advance loans**

Many candidates disallowed this expenditure considering that it was not incurred for the purposes of business. However, they lost sight of the fact that the profit was paid to a bank on a loan taken for advancing concessional loans to staff as per the terms of their contracts of employment, hence admissible. [s. 20(1)]

**Part (b)**

This part was attempted fairly well by a majority of the candidates. Some candidates did not off- set brought forward business losses from the tax year 2010 which should have been off- set from the taxable income of the tax year 2014.

Further, candidates while computing tax payable should give full credit of different amounts of tax deducted/collected during the tax year and mentioned in the question with respect to various transactions given therein.

**Question Two**

This question carried 25 marks and was set around a non-Pakistani salaried individual who was resident in Pakistan for the tax year 2014. This question was attempted very well by most of the candidates. However, a few common mistakes noted in the scripts are discussed below:

**Part (a)**

(i) **Fixed medical cost**

Ms Xiang was given Rs. 400,000 as fixed medical cost regardless of her actual medical expenditure. Ten percent of the basic salary was exempt. Hence, only the amount of Rs. 160,000  $(400,000 - (2,400,000 \times 10\%))$  [Cl. (139) of Pt. I of 2nd Sch.] was to be added back.

(ii) **Perquisite representing car**

A few scripts contained incorrect additions on account of perquisite representing facility of the car provided to her. Where a car is provided for personal as well as business use, 5% of the fair market value of the car is treated as salary income on account of this perquisite. In such a case, total lease rentals paid over the lease term or the lease rentals paid during the year were not relevant for the computation of the value of perquisite.

(iii) **Services of a security guard**

Since the services of the security guard were provided by the employer, the tax chargeable to Xiang will include the total amount paid to the security guard, reduced by Rs. 120,000 paid by Xiang. Some candidates treated the whole amount of Rs. 216,000 as perquisite which was not the correct treatment.

(iv) **Loan given to Xiang**

Xiang was given a loan at a markup of 6% per annum on 1 August 2013, whereas the benchmark rate for the tax year 2014 was 10% [s. 14(a)(ii)]. A few candidates taxed incorrect amounts resulting in miscalculations. Further the amount of the loan obtained was not used for the acquisition or construction of a house, therefore, it was not eligible for any tax credit. [s.64]

(v) **Sale proceeds from the sale of Chinese food supplements**

Tax collected at the import stage at 5.5% of the import value of Rs. 400,000 was to be treated as the final tax on the income of the importer arising from such imports. [s.148 read with s.169] The net income was not relevant for the purpose of computation of tax and was not required to be computed. Some candidates computed net income and charged tax on the net income basis which was not correct.

(vi) **Sale proceeds from sale of toys**

The transaction had resulted in a loss. However, the loss from this transaction was not eligible for set off against income under any other income. Tax collected at the import stage at 5.5% of the import value of Rs. 500,000 at Rs. 27,500 was to be treated as the final tax. [s.148 read with s.169]

**Part (b)**

It carried one mark and required candidates to state the last date by which Xiang needed to file her return of income. Being a salaried person, she was required to file the return of income by 31 August 2014. Some candidates were not aware of this statutory date of filing of return by salaried individuals. [s.118]

**Part (c)**

Some candidates replied that Xiang was not required to file a wealth statement with her return of income for the reason that she was not a citizen of Pakistan. However, since she was resident in Pakistan, she was under obligation to file a wealth statement. For the purposes of filing the wealth statement, residence status is relevant and not the citizenship. [s.116]

### Question Three

The following common errors should be avoided to get good marks on a capital gains tax question:

- (i) Some candidates totalled all capital gains and then taxed them together with other income. However, capital gains on account of each security [as defined in section 37A of the Ordinance] has to be treated separately and taxed at the rate applicable to it depending upon its period of holding before its disposal.

Similarly, capital gains on the disposal of immovable property is also taxable as a separate block. The rate of taxation of such gains is also given in the question paper and varies according to its period of holding.

All of the other capital gains are computed under the heading 'capital gains' and taxed along with income under the other heads of income, if any, as a component of total income.

- (ii) While computing the capital gain on the sale of the house owned by the taxpayer in Islamabad, a few candidates did not allow commission paid to the broker as a deduction against the sale proceeds, which is incorrect. Any expenditure incurred for the purchase or sale of a capital asset is an admissible deduction [provided that it is not inadmissible under section 21].
- (iii) Since 50% of the shares in Balochistan Minerals (Pvt.) Ltd (BMPL) were held by the provincial government of Balochistan, BMPL was to be treated as a public company and its shares were to be treated as securities. [s. 2(47)(a) & s. 37A(3)] Some candidates did not realise this aspect and did not tax it as a separate block.
- (iv) There are certain capital assets on the disposal of which a capital gain is taxed, but a loss is not recognised for set off against other capital gains. [s. 38(5)(b)] One such asset is jewellery. Some candidates set off the loss on the theft of the jewellery against other capital gains to arrive at a net taxable capital gain which was not the correct treatment.
- (v) Speculation income or loss is to be treated as a separate type of income. A speculation loss from one source can only be set off against speculation income from another source but it cannot be set off against any other type of income. A few candidates allowed it against capital gains resulting in erroneous computation of taxable gains and tax thereon.
- (vi) Where an asset [other than immovable property or security] is disposed of after holding it for more than one year, only 75% capital gain is to be taxed. Ignorance of this parameter results in incorrect computation of taxable capital gain and tax thereon.

### Question Four

This question was not answered well with the majority of candidates not attempting it at all. The main errors included:

**Part (a)**, carrying five marks, tested the candidates' knowledge about advance tax payable in four quarterly installments and computation of the default surcharge where any installment is not paid in time. The default surcharge was payable at 18% per annum on the amount of tax not paid for the period starting on the date it

was due and ending on the date on which it was paid or 30 September 2014 when his return of income was due, whichever is earlier. [s.147(5) read with s.205(1A)] While some candidates did not know the correct dates of payment of advance tax, others were not aware of the rate of default surcharge.

**Part (b) (i)**, required a computation of the penalty for late filing of the return of income. The penalty for late filing is 0.1% of the tax payable on the declared income in the income tax return, for each day of default, subject to a maximum penalty of 50% of the tax payable and a minimum penalty of Rs. 25,000. [sr. 1 of table to s.182(1)]

**Part (b) (ii) - Imposition of penalty where no tax is payable with the return of income**

For the purposes of the computation of the penalty for the late filing of a return, tax chargeable on the basis of declared income is computed and the penalty is payable with reference to this tax liability. This means that, even in cases where all of the tax liability on the basis of the declared income stands discharged before or with the filing of the return, the penalty will still be payable on the basis of tax chargeable on the declared income. [Explanation to sr. no. 1 of the table to s.182(1)]

**Part (c)(i)** carried three marks. It tested candidates' knowledge about income from unexplained sources. The correct treatment of the given amounts was as follows:

**1 Foreign remittance**

Since the amount of Rs. 1,000,000 originated from foreign exchange through normal banking channels and was cashed into Pakistan rupees by a scheduled bank, it was not taxable. [under s.111 (4)(a)]

**2 Cash received from uncle**

Since Mr Basharat had received the amount from his uncle and all the documentary evidence to this extent was available, it was not taxable under section 111 as income from unexplained sources. However, since the amount was received as cash and not through the allowable modes of receipts, it would have been taxed under the heading, 'Income from other sources' as required to be answered in part (c)(ii) of this question.

**3. Agricultural income**

Out of Rs. 2,000,000, only Rs. 300,000 was explainable as originating from agricultural income on the basis of provincial agricultural income tax paid by the taxpayer. The balance was to be taxed as income from unexplained sources. [second proviso to s.111(1)]

**Question Five**

**Part (a)**, carrying seven marks, required computation of sales tax liability of a registered person. Where supplies were made to unregistered persons, a further tax of 1% of the value of supplies was to be charged in addition to the standard rate of 17%. [s.3(1A)] Some candidates did not compute this tax liability.

Another mistake was not to give credit of sales tax of Rs. 300,000 brought forward from December 2013.



**Part (b)** asked the candidates to state the due date of filing of the sales tax return for the month of January 2014. The correct answer was 15 February 2014. However, where the amount of tax had been paid by 15 February 2014, the return could have been filed electronically until 18 February 2014.

**Part (c)**

Some candidates did not state that a registered person can file a revised return, with the approval of the Commissioner, within 120 days of the filing of the return to correct any omission or wrong statement made therein. [s.26(3)]