

Examiner's report

F6 (PKN) Taxation

December 2016

General Comments

There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of 15 multiple choice questions (two marks each) which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions worth 15 marks each testing the candidates' understanding and application of tax law in more depth covering different areas of the prescribed syllabus. The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

Section A

It was very pleasing to see that almost all candidates attempted all of the questions. Some candidates obtained good marks while a few did not perform well. To get good marks, future candidates are advised to cover all the syllabus areas rather than attempting selective studies of any particular topic.

The following two questions, which were not satisfactorily answered by many of the candidates, are reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with examination questions of this type and to provide a technical debrief on the topics covered by the specific questions selected.

Sample Questions for Discussion

Example 1

Which of the following persons is/are NOT required to file a return of income?

- (1) A non-resident individual having no source of income in Pakistan but having a residential plot of 1,000 square yards
- (2) A widow having income of Rs. 800,000 from the rent of a house owned by her
- (3) A married woman having no source of income who has a 1500 cc motor car registered in her name
- (4) A non-resident who derived capital gains of Rs. 600,000 on the disposal of shares in an unlisted company which was resident in Pakistan

- A** 1 and 4
- B** 1 only
- C** 2 and 3
- D** 2 only

The correct answer was **B** [s.115(3)(d)]. However, a number of candidates answered it wrongly as option "D" or "A". The candidates lost sight of the fact that the widow had earned taxable income and was, therefore, required to file her return of income. Had she only been an owner of a house and not earned taxable rental income, then she would have not been required to file return of income. Option "A" was also incorrect because though statement (1) was correct, statement (4) was incorrect. Pakistan source income earned by a non-resident is to be reported in Pakistan by filing a return of income. Hence, "A" was not a correct answer. The only correct statement was (1). All other statements contained one or more conditions which required the filing of a return.

While attempting questions of exception/exemption, all the requisite elements necessary for such exception/exemption should be present in the given situation. Further the correct statement shall not contain any condition which deprives from exemption or such exception.

Example 2

In the case of a company, what was the last date for payment of advance tax for the quarter ended 30 September 2015?

- A 15 September 2015
- B 15 October 2015
- C 25 September 2015
- D 1 October 2015

Whereas a number of candidates opted for “A”, the correct answer was option “C” [s.147(5A)]. The candidates should have realised that this question was about a company and not an individual. Had it been a case of the individual, the last date for payment of advance tax in the question would have been 15 September 2015. It appears that options “D” and “B” chosen by some candidates were merely on the basis of guesswork that a date might be after the concerned quarter is ended.

In taxation matters, the letter of the law is to be followed strictly.

Section B

Question One

Question one carried 10 marks. Part (a) for four marks required candidates to state the four circumstances in which the Commissioner Inland Revenue (the ‘CIR’) can make a best judgement assessment order against a taxpayer. This part of question was either not answered or answered wrongly. The CIR is empowered to issue a best judgment assessment order in case of any of the following defaults:

- i. statement of final taxation is not filed in response to a notice by the CIR;
- ii. return of income is not filed by a taxpayer being a non-resident owner or charterer of a ship or an air-craft;
- iii. wealth statement is not filed; or
- iv. accounts or other related documents are not filed by a taxpayer on the requisition by the CIR or any other authorised person.

Part (b) carrying six marks required the candidates to list the persons who can appear as an authorised representative of a taxpayer before the Appellate Tribunal Inland Revenue (‘ATIR’). Many candidates did not answer it fully. Income tax practitioners (including ACCA members), any accountant, full time employees of a taxpayer, legal practitioners, an officer of the taxpayer’s banker and in the case of a non-resident his representative under section 172 can represent a taxpayer before the ATIR. Candidates in future sessions are advised to give due attention to theoretical areas of the syllabus so that they can earn good marks easily.

Question Two

This 10-mark question consisted of three parts. Part (a) required candidates to state the four circumstances in which a company is treated as a resident company. Answers in most of the scripts were satisfactory. A company incorporated or formed by any law in Pakistan or having its full control and management in Pakistan is treated as a resident company. Similarly, provincial governments and local governments in Pakistan are also by definition companies resident in Pakistan.

Part (b) required computation of gain on the disposal of a car used for business. Originally cost of the car at Rs. 6,000,000 had been reduced to Rs. 2,500,000 for the purposes of the tax depreciation. The tax written down value of the car at the time of disposal was Rs.1,535,300. The sale proceeds of Rs. 4,500,000 were thus to be reduced proportionately to Rs. 1,875,000 ($2,500,000 \div 6,000,000 \times (4,500,000)$). Some candidates did not

reduce the sales proceeds and hence reached a wrong answer. Further the gain was to be taxed under the head “Income from business” being the disposal of an asset on which depreciation had been claimed. Some candidates treated it as a capital gain which was incorrect.

Part (c) carrying three marks required computation of tax credit on account of listing of a company on a stock exchange in Pakistan. No tax credit was admissible in the tax year 2015 in which the process of listing started. It was available only in the tax year 2016 when it was finally listed after completion of the process. Some candidates computed credit for both the tax years. A few candidates applied the wrong rate of tax credit. However, the overall attempt was satisfactory.

Question Three

This 10-mark question required computation of capital gains/loss on the disposal of certain assets and tax payable thereon. A common mistake found was the incorrect computation of the cost of 8,000 shares in MNO Ltd while computing the capital gain. The total shareholding acquired on different dates was 9,000 shares. A few candidates took cost of 9,000 shares while computing the capital gain. Others did not deduct incidental charges of Rs. 8,000 from the sale proceeds in computing the capital gain. A few candidates computed the loss on the disposal of personal car and set it off against the capital gains. However, no such loss on the disposal of movable assets like a car held for personal use can be set off against capital gains. Movable assets held for personal use are generally not included in the definition of a capital asset. However, there are certain exceptions to this general rule. Candidates should keep in mind assets which fall in these exceptions on the disposal of which while no capital loss is recognised, capital gain is taxable. A car does not fall in such exceptions. Questions involving such exceptions often appear in the F6 PKN exam.

Question Four

This 10-mark question required computation of sales tax payable by a person for the tax period April 2016. This question was generally very well attempted in this session. Some candidates, however, treated supplies made to the teaching hospital of a statutory university having 100 beds as exempt. However, such exemption was available to such hospitals only when their number of beds was 200 or more.

A few candidates taxed supplies made for consumption on an airplane proceeding abroad (London). Supplies for consumption aboard any conveyance proceeding to a destination outside Pakistan are exempt from the levy of sales tax.

Question Five

This question was based on the computation of taxable income of a company, in part (a) for 13 marks, and tax payable thereon, for two marks in part (b). While part (b) was attempted satisfactorily, a number of the answers to part (a) were unsatisfactory. The candidates need to identify and treat correctly which expenses are allowable and which are not. Where such expenses are to be partly allowed, their correct computation based upon the relevant criteria is very important.

Mistakes commonly found in a number of scripts are discussed below:

- i. Compensation of Rs. 160,000 paid to a customer for breach of a contract was not to be equated with a penalty for violation of a law, hence it was allowable. Many candidates disallowed this amount wrongly.
- ii. Rs. 150,000 paid to an employee on termination of his services without giving notice was within the definition of salary and fully admissible. Adding this back to the taxable income was not the correct treatment.
- iii. Expenditure incurred on the construction of a security room was not correctly treated by most the candidates. Since the expenditure resulted in the construction of a capital asset, it was not allowable as a straight deduction. However, it was eligible for deductions computable as initial allowance and depreciation in accordance with their given rates.
- iv. Interim dividend paid was to be added back being not an expenditure to earn income, rather it

was a distribution of income. The candidates should keep in mind the difference between treatment of amounts paid to earn income and to distribute the earned income. The latter amounts (e.g. dividend) are not admissible deductions.

Question Six

This question carried 15 marks and was set to compute taxable income of a salaried person and tax thereon. In the case of salary income, the general principle should be kept in mind that all allowances received by an employee in connection with performance of his employment are taxable provided that they are not exempt under any clause of the Second Schedule to the Income Tax Ordinance, 2001 (the 'Ordinance'). As regards perquisites, their value is to be computed as provided in section 13 of the Ordinance and the related rules. In case there is any benefit derived under the employee share scheme, section 14 of the Ordinance comes into play. By correctly applying the principles given in these few provisions, the candidates can all the available marks.

In this session common mistakes found in respect of certain items are clarified below:

- i. Annual meal allowance of Rs. 360,000 was taxable and not exempt.
- ii. Annual accretion to the balance at the credit of the employee in the recognised fund was Rs. 200,000. Amount above Rs. 100,000 was taxable. [Rule 3(a) of Pt. I of Sixth Schedule]
- iii. Fee of directorship received during the year was taxable fully at Rs.100,000.
- iv. A few candidates did not tax Rs. 28,000 received from delivering lectures which was an income taxable under the head 'Income from other sources'.
- v. Income from IT enabled services was exempt under [Cl. (133) of Pt. I of] the 2nd Schedule to the Income Tax Ordinance, 2001.
- vi. Unless specified otherwise in the law, the general rule of taxation of salary is on a receipt basis. Since the bonus was not received during the tax year 2016, it was not to be added as part of the taxable income in that tax year. A few candidates wrongly taxed it in the tax year 2016.
- vii. Another principle of taxation of salary income is that expenses incurred by an employee wholly and exclusively on behalf of his employer in the performance of the employee's duties of employment and reimbursed by the employer are not part of the salary income. Hence the amount of Rs. 80,000 incurred for business trips and reimbursed to the employee was not taxable.

In summary, candidates who want to take examination in F6 PKN Taxation (Pakistan), can get good marks if they study the whole syllabus and read the question requirements carefully to take note of all the relevant factors given therein to reach the correct answer. Good luck!