

Examiner's report

F6 Taxation (PKN)

June 2015



General Comments

The examination consisted of two sections. Section A consisted of 15 compulsory questions each of two marks. Section B contained four questions each of ten marks and two questions each of 15 marks.

Candidates performed well on questions 5 and 6(a). The questions candidates found most challenging were questions 1, 2(b) and 6(b). Question 1(a) as a new topic area introduced by the Finance Act 2014, should have been prioritised by candidates and given due attention while preparing for the examination. The candidates sitting for the next examination are advised to keep themselves updated with the amendments brought about in the latest examinable Finance Act 2014.

Specific Comments

Section A

Section A consisting of 15 multiple choice questions for 2 marks each was included in the paper for the first time. The questions in section A aim to provide a broad coverage of the syllabus, and future candidates should try to revise all areas of the syllabus to get good marks in the paper, rather than attempting to question spot. The following question has been reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific question selected.

Example Question

ABC Ltd paid a fee of Rs. 24,000 to one of its directors, Kiyani, for attending a meeting of the board of directors on 5 June 2015. Kiyani's other taxable income under the head 'Income from other sources' was Rs. 726,000 in the tax year 2015.

What is the amount of tax which ABC Ltd should have deducted from the payment it made to Kiyani during the tax year 2015?

- A Rs. 4,800
- B Rs. 0
- C Rs. 1,120
- D Rs. 2,400

Candidates were required to choose the option containing the correct amount of tax to be withheld by the company. While the correct answer was Option A, calculated by applying the given rate of 20% on the gross amount of fee paid by the company, the other options were based on some distracters/wrong reasons as below:

- B Rs. 0

Prior to the Finance Act 2014 (applicable from the tax year 2015 for the first time), no deduction was required to be made by a company from the fee paid by it to a director for attending its meeting. This option was based on the old provision.

- C Rs. 1,120

This option was given on the analogy of tax deduction from salaries on the average rate of tax $(35,000/750,000 \times 24,000) = 1,120$. The computation was based on the total tax payable on the basis of total income including fee and applying the rate of tax as per the first schedule to the income tax Ordinance, 2001.

D Rs. 2,400

In this case the base amount was correct, but the rate of tax deduction (10%) applied was that applicable to fee for services rendered. Since the director of the company was not an employee of the company, it comes to mind as if rate of services might apply. However, since specific rate was prescribed for fee for attending board's meeting, no other general rate was to be applied.

Section B

Question One

This 10-mark question contained two parts. Part (a) tested knowledge of the candidates regarding taxation of bonus shares issued by a private company and part (b) was about whether the given company had permanent establishment in Pakistan or not.

In part (a), the number of bonus shares to be issued was 30,000 and its value was to be taken at Rs. 20 per bonus share being the value of one bonus share on the first day of the book closure. Tax was to be collected by the issuing company at 5% and in case of non-payment, the company issuing the bonus shares was authorised to sell the bonus shares to recover the amount of tax and deposit it in the government treasury.

In part (b) candidates were to identify whether in the given situations China Agrochemicals Ltd. had a permanent establishment in Pakistan or not. A liaison office situated in Pakistan will be treated as permanent establishment if it engages itself in the negotiation of contracts being other than contracts of purchase. Further, a person having land in Pakistan is also treated to have a permanent establishment in Pakistan.

Question Two

This 10-mark question covered the topics of taxation of gratuity and perquisite arising from a concessional loan.

The core issue of part (a) for five marks was to state/compute the correct amount of taxable gratuity in the given situations and in one case the computation of tax involving a taxable gratuity. The candidates were expected to know that a gratuity received from a gratuity fund approved by the Commissioner was fully exempt, whereas that received from a gratuity fund approved by the Federal Board of Revenue was exempt up to Rs. 200,000. Where the gratuity was received from an unapproved gratuity fund, 50% of the amount of the gratuity received or Rs. 75,000, whichever was lower, was exempt from tax.

Part (b) for five marks required the computation of tax on the given income of a person by including in it the value of perquisite on account of concessional loan. The difference between the amount of profit charged and the benchmark up rate was just one percent and on the total amount of loan of Rs. 9,000,000, it gave a perquisite of Rs. 90,000 which was to be added to the other income and taxed at the rates already given in the question paper.

Question Three

This 10-mark question was based on capital gains. Part (a) which required candidates to state assets on the disposal of which a gain is taxable, but a loss is not recognised. It was well attempted and needs no comments.

Part (b) carrying seven marks asked candidates to compute the capital gain and tax payable thereon on the disposal of the given capital assets. In this part, the charge for safe custody of the bracelet was not deductible, but some candidates treated as deductible while computing the capital gain on the sale of gold bracelet. Further, it needs to be understood that gain on sale of land is taxable as a separate block at the prescribed rates and not to be included with the other capital gains.

Question Four

This 10-mark question was about sales tax liabilities of a person registered under the Sales Tax Act, 1990. Part (a) of the question dealt with the circumstances under which the registration of a registered person can be suspended or a registered person can be de-registered. It was answered fairly well.

However, candidates are also required to know that no sales tax refund or input tax credit is admissible to any person on the basis of any invoice issued during the period of suspension of registration.

Part (b) for five marks asked the candidates to state how the value of supply would be determined where goods are supplied at a discounted price and also where the consideration for a supply is received partly in kind and partly in cash.

The value of supply is to be taken at a discounted price provided that the discounted price and the related tax is shown on the sales tax invoice and the discount allowed is in conformity with the normal business practice in the industry.

Where consideration is received partly in kind and partly in cash, the value of the supply for sales tax purposes would be taken as the open market price of the supply excluding the amount of sales tax.

Question Five

The first question carrying 15 marks required computation of taxable income and consequent tax liability of a resident private company engaged in the business of manufacture and sale of poultry feed for the local market. Part (a) required computation of taxable income and part (b) required computation of the tax payable by the company on the basis of taxable income computed in part (a).

The common mistake was taxation of profit on debt at 10% as a separate block of income. In the case of a company, profit on debt is assessable under the head 'Income from other sources' and taxable at the normal rate of tax applicable to the company.

The trading liability (Rs. 500,000) allowed on an accrual basis in the tax year 2011 but not paid until the tax year 2014 was to be added back in the tax year 2015 [s. 34(5).]

Further, although the addition in plant and machinery was of Rs. 5,000,000, only plant and machinery of Rs. 3,000,000 which had not previously been used in Pakistan, was eligible for the initial allowance at 25%. This aspect was not kept in mind by some candidates while computing the initial allowance and depreciation.

Question Six

This was the second long question for 15 marks and was set on the computation of taxable income and tax of an association of persons (AOP) in part (a) and its members for part (b). In part (a), the common mistake found was in calculating the excess depreciation claimed by the AOP in respect of a computer used during the tax year 2015. The correct computation was as follows:

	Rs.
Cost of new computer	100,000
Initial allowance (100,000 x 25%)	<u>(25,000)</u>
Written down value for depreciation	75,000
Allowable depreciation (75,000 x 30%)	22,500
Excess claim of depreciation (30,000 - 22,500)	7,500

In part (b), candidates should also have been aware that:

- (i) While computing divisible income, payments made to members on account of salary, commission, performance bonus, profit, etc are to be deducted from the total income of the AOP;
- (ii) The share of income of a member from an AOP is added in the other income of the member only for determining rate of tax, but tax payable is to be computed only on the income other than the share from the AOP.