

Examiner's report

F6 (PKN) Taxation

June 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

All the candidates attempted all of the questions. However, the answers showed lack of proper preparation and coverage of all areas of the syllabus. They could have earned more marks, had they revised all areas of the syllabus rather than resorting to a selective study of some areas. Future candidates of F6 PKN are expected to cover all areas of the syllabus by taking note of decisive factors for a correct answer in each given situation.

The following two sample questions from previous examinations are 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 questions selected.

Sample Questions for Discussion

Example 1

In the tax year 2015, Alia was present in Pakistan for 120 days before she was posted abroad by her employer.

In which of the following situations will Alia be treated as resident in Pakistan for the tax year 2015?

- A** She was an employee of Lahore Development Authority in the tax year 2015
- B** She was an employee of a listed company incorporated under the Companies Ordinance, 1984 in the tax year 2015
- C** Her permanent residential address is in Pakistan
- D** She was an employee of the Government of Pakistan in the tax year 2015

This question tested the knowledge of the candidates to identify the situation in which a salaried person can be a resident in Pakistan despite having less than 183 days' stay in Pakistan during a given tax year.

If a person is an employee of the Federal Government or of a provincial government and is posted abroad, such person would be treated as resident in Pakistan. No other criterion is relevant in such case. In option A, the employer was a development authority which despite being a statutory body

was neither a provincial government nor the Federal Government. In Option B, though the employer was a resident company, the employee posted abroad cannot be treated as resident on this account. Option C is again a distracter referring to her residential address in Pakistan. The relevant factor is the length of physical stay in Pakistan for at least 183 days and not the mere existence of a residential address in Pakistan. Option D is the correct answer because she had been posted abroad by the Federal Government, hence, irrespective of her stay in Pakistan, she was to be treated as resident in Pakistan.

Example 2

An inconsistency has been found between a circular and an advance ruling both of which were issued by the Federal Board of Revenue ('FBR').

Which of the following correctly describes the appropriate action as per the law?

- A** Priority will be given to the terms of the advance ruling over the circular
- B** Priority will be given to the terms of the circular over the terms of the advance ruling
- C** Both will be cancelled and the matter will be referred back to the FBR again
- D** The Commissioner will give priority to the circular and the taxpayer will give priority to the terms of the advance ruling

A non-resident person is allowed the facility of getting advance ruling in respect of tax implications of a transaction to be undertaken or already undertaken by such non-resident person. In this question, its prevalence over a circular and its binding on the tax authorities was tested. Option A was the correct answer stating the prevalence of the advance ruling over the circular. Option B was the opposite to the correct position. Option C presented an incorrect answer that in case of inconsistency between a circular and an advance ruling, both were to be cancelled making issuance of an advance ruling meaningless. Similarly, Option D should have alerted the candidates that it was not possibility because otherwise it would have created a deadlock and not provided a solution in a given situation. Thus the correct answer is Option A.

Section B

Question One

This 10-mark question covered the topics relating to revisionary powers available to the Chief Commissioner, the difference between a direct and an indirect tax, and additional payment for delayed issuance of refund.

Part (a) for 4 marks required candidates to give answers regarding the exercise of revisionary jurisdiction by the Chief Commissioner in respect of exemption/concessionary certificates issued by their subordinate authority from the tax deduction/collection at source. The candidates were expected to know that such power can be exercised by the Chief Commissioner on his own or on the request of a taxpayer and that the Chief Commissioner has the powers to get an inquiry conducted in this regard if deemed fit. Further opportunity of hearing was required to be afforded to the taxpayer before passing any revisionary order. The candidates were found not to have

prepared for this important topic. Future candidates are advised to study all the areas of the syllabus.

Part (b) regarding difference between a direct and indirect tax was attempted fairly well. The candidates knew correct examples of each type even if they could not make precise statement of the difference. Whereas in the case of direct tax (e.g. income tax etc) the burden of tax is borne by the same person on whom the tax is levied, in case of indirect taxes, the person who pays the tax in the first instance shifts its burden to another person, for example sales tax, etc.

Part (c) for two marks was set to compute the additional amount on delayed payment of a refund of Rs. 500,000 for 150 days. The eligible days for compensation were 60 and the rate of compensation was 6.5% per annum [KIBOR + 0.5%] giving an answer of Rs. 5,328. Rights of the taxpayers is an important area of the syllabus to which future candidates should give due attention to gain good marks.

Question Two

This 10 mark question consisted of three parts. Part (a) required calculation of tax credit on an amount of Rs. 400,000 contributed to an approved pension fund. Total taxable income was Rs. 1,500,000. On the basis of tax credit so computed, tax payable was also to be computed. Candidates calculated tax credit on the amount of Rs. 400,000 but forgot that the eligible amount could not have exceeded 20% of the taxable income. Consequently, the tax credit and tax payable were not correctly computed. Future candidates are advised that the words used in the law “whichever is lower” or “whichever is higher” must be considered while computing such eligible amounts.

Part (b) was about residential status of a person. The question was correctly answered by taking into account the minimum 183 days of stay in Pakistan for assigning the status of resident to a person.

Part (c) carrying four marks tested the knowledge of amended law that loss from business was no longer eligible to be set off against ‘Income from property’ [or against ‘salary’ income]. Candidates in general were found not aware of this important examinable amendment in the law.

Question Three

This 10-mark question covered the topics of capital gains. Two marks were allocated to part (a) requiring candidates to state the tax implications of disposal of an asset in a non-arm’s length transaction. The only implication in such a case is that the Commissioner is empowered to take the fair market value of the asset as the sale and purchase price for the seller and the buyer, respectively. Some candidates could not answer this question correctly.

Part (b) for 8 marks required the computation of capital gains/losses on the disposal of certain assets. A common mistake found in this part was that candidates could not differentiate between the capital gains taxable as part of the total income and the capital gains which were taxable as a separate block .

Future candidates should keep in mind that a capital gain on the disposal of an immovable property is taxable at a prescribed rate as a separate block. Similarly a capital gain on the disposal of securities [as defined in section 37A(3)] is taxable at prescribed rates as a separate block. Other capital gains are taxable as part of total income.

Question Four

This 10-mark question required computation of sales tax payable by a person for the tax period May 2016.

Examination of the scripts shows that some candidates could not differentiate between output tax and input tax. Broadly speaking output tax is the sales tax which a person is to pay on the sales made by such person. Input tax represents sales tax paid by such person on the inputs used by such person in making sales of the goods manufactured from those inputs.

Further, candidates should bear in mind that when making sales to unregistered persons, in addition to the standard rate of 17%, an additional tax at 2% is also to be charged. Another mistake was not allowing tax credit of input tax brought forward from April 2016 which was well within the prescribed limit of six months and fully admissible against the output tax. Future candidates may give special attention to admissible and inadmissible input tax against output 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 2 marks.

A fundamental mistake found in some papers was that while the candidates started with the figure of 'profit before tax' as per the income statement, they again deducted some admissible expenditure or deductions without realising that in arriving at 'profit before tax', such expenditure /deductions had already been allowed. Such items were only to be explained in 'items not included in the computation of taxable income'. In some scripts, the impact of the sale of the car was not properly accounted for taxation purposes. An accounting loss on the disposal of an asset is not allowable and the amount of accounting loss was to be added back while computing taxable income. Further, any gain or loss for tax purposes was to be computed with reference to the tax written down value of the car at the time of its disposal and the consideration received as follows:

	Rs.
Consideration received for the sale of the car [A]	1,930,000
Actual cost of the car [B]	3,000,000
Value restricted for tax depreciation [under s.22(13)(a)] [C]	2,500,000
Sale proceeds for computing the gain or loss [A/B x C]	
[(1,930,000/3,000,000) x 2,500,000] [D]	1,608,333
Less: Tax WDV of the car [E]	<u>1,535,000</u>
Taxable gain on the sale of the car [D – E]	73,333

Another mistake found in the scripts related to the treatment of computer software. Some allowed the whole amount of software purchased in the current year and a few others treated it as part of computer hardware and allowed tax depreciation thereon. Computer software is an intangible [s.24] and its cost of Rs. 400,000 was to be amortised over its given useful life of four years. Since it was not used for the whole year in the tax year 2016, its yearly amortisation in the tax year 2016 was to be restricted on proportionate basis:

$$(400,000/4) \times 182/366 = \text{Rs. } 49,727$$

Part (b) for 2 marks was correctly attempted except in some cases where the candidates wrongly allowed the advance tax paid from the taxable income. The amount of tax paid was to be allowed from the tax liability arising on account of the taxable income and not from the taxable income itself.

Question Six

This question consisted of two parts. Part (a) for two marks was about the Pakistan source salary income. Salary received is considered Pakistan source income if it is either the result of employment exercised in Pakistan or it is received from the Federal Government, provincial government or a local government in Pakistan irrespective of place of exercise of employment.

Part (b) carried 13 marks and required computation of taxable income of a salaried person and tax payable on such taxable income. Computation of taxable salary income is an important area of the syllabus and is included in every exam in one form or another. Hence future candidates should give special attention to this area of the syllabus. Also the treatment of the medical allowance was not correctly done by candidates. The correct treatment was to tax the medical allowance in excess of 10% of the basic salary. The value of the perquisite of the car provided to the employee for his personal use was to be computed at 10% of its fair market value on the date of lease by the employer. Some candidates wrongly computed the taxable amount at 5% of the fair market value. Further, the amount received in lieu of holidays, utility allowance and school fee of the employee's daughter paid by the employer were also fully taxable. Future candidates should keep in mind that all perquisites whether in kind or in cash were taxable to the extent prescribed in section 13 and the allied rules, unless exempted under the second schedule of the Income Tax Ordinance, 2001.