

Examiner's report

F6 Taxation (PKN)

December 2013

General Comments

The examination paper consisted of five compulsory questions. Question one for 30 marks and Question two for 25 marks, dealt with the income tax affairs of a company and an individual, respectively. Question three, carrying 20 marks, mainly related to the computation of capital gains and tax thereon. Question four having 15 marks dealt with the rights and obligations of the taxpayers and was mostly narrative in nature. Question five was set on sales tax and carried 10 marks.

Many candidates attempted all five questions, and there was no evidence of time pressure. Where any question was left unanswered, it was likely due to a lack of necessary knowledge, as evidenced especially in question 4.

Some candidates achieved satisfactory marks. Analysis of the scripts which fell short of passing marks indicated that all parts of the questions were not attempted. Candidates for this paper are advised to study the syllabus guide to ensure that they are fully aware of what they are expected to know.

As in the past, there were scripts that indicated that candidates had applied for one variant but prepared for another variant. All candidates are, therefore, advised to be sure which variant they are going to sit in the examination and prepare for this variant accordingly.

Amendments brought about in the latest Finance Act should also be an area of special attention for candidates.

Specific Comments

Question One

Question one was about the income tax liability of an unlisted company. Since the company had 1,000 employees, it was not a small company and the applicable rate of tax was 35%. Most candidates attempted this question and achieved satisfactory marks. However, scripts that did not obtain satisfactory marks often included the following common mistakes:

Part (a)

Computation of taxable income

- i. Intangible – Rs. 1,500,000

The non-exclusive, non-transferable right for the production of an item is defined as an 'intangible' in the Income Tax Ordinance, 2001. The full cost of the intangible should not be allowed in a single tax year. It should be amortised over 10 years despite its given useful life of 15 years. [s. 24] some candidates deducted the full amount and others amortised it over 15 years, both of which was an incorrect treatment.

- ii. Freight inwards paid in cash-Rs. 1,000,000
Although generally expenses incurred in cash are not allowable as deduction, there are certain exceptions. Freight inwards is one such exception. It was therefore, deductible, if incurred for the business, irrespective of its mode of payment. Candidates should bear in mind exceptions to the general rule. [second proviso to s. 21(I)]
- iii. Initial allowance-Rs. 737,500; and
Depreciation - Rs. 5,353,125

Computations of initial allowance and depreciation are an important component of the computation of taxable income of a taxpayer. Candidates should bear in mind the following points in order to avoid mistakes

- i. No initial allowance is admissible on vehicles not plying for hire.[s. 23]
- ii. Where an initial allowance is allowed on an eligible asset, the value of the asset for tax depreciation purposes shall be reduced by the amount of initial allowance.
[Ss.22& 23]
- iii. Initial allowance and depreciation allowance are admissible only when an asset is brought into use in the business and not merely on purchase. Therefore, neither initial allowance nor depreciation allowance was admissible on the computer purchased for a value of Rs. 300,000 which was not put to business use during the tax year 2013.
- iv. Accounting depreciation is added back to declared income and only tax depreciation is allowed. [s. 22]
- v. Rates of tax depreciation and initial allowance should be applied as given in the tax rates and allowances in the front of the paper to avoid mistakes.

- iv. Scholarship granted to a Pakistani citizen-Rs. 150,000
Many candidates disallowed this amount on the basis that the beneficiary was not an employee of the company. This was not the correct treatment under s. 27(c) of the Income Tax Ordinance, 2001 according to which a scholarship granted to a Pakistani citizen for his technical training under a scheme approved by the Federal Board of Revenue is an admissible deduction.

Part (b)

This part was attempted reasonably well by the majority of candidates and no further comment is required.

Part (c)

Recovery of tax from Goodluck Ltd.

The same tax liability cannot be recovered both from the withholding agent and the payee. Some candidates ignored this principle while answering this question. When an amount of tax is recovered from one of them, it cannot be recovered from the other. In this case, Goodluck Ltd was liable to pay default surcharge only and not the principal amount of tax.

Question Two

This question carried 25 marks and involved a non-salaried individual who also received a share of profit from an association of persons (AOP).

The question was generally well attempted. Common mistakes are discussed below:

Part (a)

i. Share from AOP- Rs. 250,000

The majority of the candidates either taxed the share of profits received from an AOP as part of taxable income or added it to the total income of Dr. Ali in computing the tax rate to be applied to the taxable income. As the income of the AOP was taxed under the final tax regime (FTR), the share of profit from it was neither liable to further taxation nor to be added when determining the rate of tax applied to other taxable income. [s. 169(2)(a)]

ii. Destruction of expired medicine- Rs. 50,000

The destruction of the expired medicine was incidental to the medical practice and allowable as a deduction. Therefore, it was incorrect for candidates to add back the costs to the total income of Dr. Ali [s. 20 and general principles of taxation]

iii. Income from ex-employer in Dubai- Rs. 450,000

Since Dr. Ali was resident in Pakistan, some candidates taxed the amount received by him from his ex-employer in Dubai. However, since Dr. Ali was not resident in Pakistan in any of the four tax years preceding the tax year 2013, his foreign source income during the tax years 2013 and 2014 would be exempt from tax in Pakistan. [s. 51(1)]

iv. Agricultural income- Rs. 40,000

Rent received from land situated in Pakistan, which is used for agricultural purposes, is agricultural income and not rental income. [s. 41(1) and (2)(a)]

Part (b)

Any mistake which is apparent from the records and which does not require further investigation/inquiry can be rectified by the Commissioner. Where a rectification order is likely to adversely affect the taxpayer (for example, in the form of an increase in tax payable or a reduction in a refund) the taxpayer is entitled to a reasonable opportunity of being heard before the passing of any such order by the Commissioner. [s. 221]

Some candidates were not aware of these aspects of a rectification order tested in the examination.

Part (c)

A number of candidates could not identify the correct number of days for which the Commissioner (Appeals) can grant a stay to a demand of tax involved in an appeal pending before him. The Commissioner (Appeals) can stay such demands for a maximum period of 30 days. [s. 128 (1A)]

Question Three

Candidates are advised to avoid the following common mistakes highlighted in some scripts this session:

- i. The definition of securities should be borne in mind and capital gains on their disposal should be treated as a separate block and taxed at the rates applicable to each security based on its period of holding by the taxpayer. Publicly listed shares of a company also fall in the definition of a security.

- ii. A taxable gain on the disposal of capital assets, other than securities, is required to be reduced to 75% where such assets are disposed of after more than one year. A few candidates did not remember this point while computing taxable gains leading to incorrect computations.
- iii. With effect from the tax year 2013, gains on the disposal of certain immovable capital assets are also taxable as a separate block of income. The provisions relating to capital gains on such assets should be studied carefully by candidates.
- iv. Amount forfeited for violation of contract of sale
Any forfeited deposit received under a contract for the sale of land or a building is to be treated as 'rent' and is taxable under the heading, 'Income from property'. Therefore, the amount of Rs. 5,000,000 forfeited by Mr Ilyas in accordance with the terms of the contract for the sale of his house to Mr Sohail should have been treated as rent and taxed as separate block of income.

Note: Candidates planning to sit the June 2014 and December 2014 examinations should bear in mind that with effect from the tax year 2014, income from property shall not be treated as a separate block of income. Furthermore, instead of taxing the gross amount of tax, deductions as per section 15A shall be allowed and the resultant income shall be added to other categories of income to arrive at total income.

Question Four

This question carried 15 marks and was mostly narrative in form. Some candidates did not attempt this question. Many candidates that did attempt the question did not fully address the points below:

Part (a), carrying five marks, dealt with alternative dispute resolution [ADR] mechanism provided under the law [in addition to appeals]. The mechanism provides that the dispute resolution committee shall consist of an officer of the Inland Revenue and two other persons from a panel consisting of chartered accountants, cost accountants, advocates, income tax practitioners and reputable taxpayers. Where the taxpayer is not satisfied with the final order of the Federal Board of Revenue on the recommendations of the ADR committee, he can pursue his remedy of an appeal from the stage it was paused due to taking the matter to the ADR. However, where either prosecution proceedings have been initiated or the dispute involves interpretation of a question of law affecting other cases, jurisdiction of the ADR will not be available. [s. 134A]

Part (b), carrying four marks required candidates to determine the last dates for filing of returns of income of different taxpayers. This is an important area as non-filing of a return will entail penalty proceedings. Candidates are advised to bear in the mind the dates provided in section 118 of the Ordinance which depend upon the category of the person and last date on which the tax year of that person ends.

Part (c) carried three marks and was about the facility allowing a taxpayer to apply for an extension to the filing deadline for a return of income. This is available to a taxpayer where a reasonable cause existed for the non-filing of the return in time. Normally, an extension of time for furnishing a return shall not exceed 15 days from the due date of furnishing of the return. [s. 119 (2) and (3)]

Part (d) carried three marks and tested candidates' knowledge of provisional assessments which can be raised by the CIR against a taxpayer who fails to file a return of income in response to a notice served by the CIR for furnishing such return. Many candidates were not aware that no proceedings can be initiated for recovery of tax as a result of such an order before the expiry of 60 days from the date the order has been served. [s122C]

Question Five

Part (a), carrying seven marks, required candidates to list the persons who were required to be registered for sales tax under the Sales Tax Act, 1990. Many candidates could not list these correctly. The following persons, who are making taxable supplies in Pakistan in the course or furtherance of any taxable activity carried on by them, are required to be registered for sales tax under the Sales Tax Act, 1990:

- (i) a manufacturer, not being a cottage industry;
 - (ii) a retailer whose value of supplies, in any period during the last 12 months exceeds Rs. 5 million;
 - (iii) an importer;
 - (iv) a wholesaler (including dealer) and distributor;
 - (v) a person required, under any other Federal law or Provincial law, to be registered for the purpose of any duty or tax collected or paid as if it were a levy of sales tax to be collected under the Act; and
 - (vi) a commercial exporter, who intends to obtain a sales tax refund against his zero-rated supplies.
- [s. 14]

Part (b) carried three marks and tested candidates' knowledge about revision of a sales tax return. The majority of candidates who attempted this part of the question achieved satisfactory marks.