Examiner’s report

F6 Taxation (PKN)
June 2013

ACCA

General Comments

The examination paper consisted of five compulsory questions. Question one for 30 marks and Question two for 25 marks, focused on income tax affairs of a company and an individual, respectively. Question three, carrying 20-marks, covered capital gains. Question four having 15 marks examined different areas of the syllabus and was mostly narrative in nature. Question five was set on sales tax and carried 10 marks.

Majority of the candidates attempted all five questions, and there was no evidence of time pressure. Where any question was left unanswered, it was probably due to not knowing the reply, as evidenced more from part (a) of question 3 and part (c) of question 4. Overall performance of candidates indicated reasonable knowledge of the level required at this stage. Many candidates scored satisfactory marks. Analysis of the scripts which fell short of passing marks indicated that full questions were not attempted which lead to the inference that candidates might not have covered the entire syllabus. Future candidates are advised to wholly cover the syllabus in their study and keep in view of the amendments made in the latest Finance Act examinable in the study guide.

Specific Comments

Question One

Question one was about the income tax liability of a public company, which being non-listed on the last day of the tax year, was to be treated as private limited company for the purposes of income tax. Most candidates attempted this question fairly well. However, scripts which could not obtain satisfactory marks showed the following mistakes:

Part (a)

Determination of residential status of the taxpayer

Vast majority of the candidates answered it correctly. When a company is incorporated under the Companies Ordinance, 1984, by definition, it becomes a resident company. A few candidates treated it a non-resident wrongly by relying upon irrelevant factors.

Part (b)

Computation of taxable income

i. Trade debts written off- Rs. 800,000
Since trade debts were irrecoverable and had been written off (and not merely provided for) in books of accounts, the amount was allowable as a deduction [u/s 29(1) &(2)] A few candidates did not allow this deduction which resulted in wrong answer.

ii. Recoveries against bad debts- Rs. 750,000
Bad debts were recovered during the year and were included in other income in the accounts of the company. Since these bad debts were not allowed as deduction in the tax year of their claim, to tax them in the year of recovery would result in double taxation which is not correct treatment. Therefore, it was to be deducted from the accounting income. A few candidates did not deduct it from the accounting income, leading to wrong computation of taxable income.

iii. Initial allowance-Rs. 1750,000; and
Depreciation - Rs. 2,662,500

Computations of initial allowance and deprecation are important component of computation of taxable income of a taxpayer. Future candidates are reminded to avoid mistakes which were observed in this session by keeping in mind the following points:

i. No initial allowance is admissible on addition in furniture and fittings and 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. Accounting depreciation is added back in the declared income and only tax depreciation is allowed. [s. 22]

iv. Intangible asset – Rs. 1,600,000

Acquisition of the contractual right to manufacture 'water-kits' for cars in Pakistan was an 'intangible' for income tax purposes. Total amount of the intangible asset was to be amortised over its given useful life of 8 years. Since it was used for only 73 days during the tax year 2013, the amount was to be allowed proportionately at Rs. 40,000 as under:

$$\frac{1,600,000}{8} \times \frac{73}{365} = 40,000. \qquad [s.\ 24]$$

Part (c)

Some candidates did not give credit of tax deducted at source when computing tax liability and failed to pick up easy marks. Many candidates did not give tax credit on the donation of Rs. 1,000,000 made in kind [u/s 61(1) & (2)].

Question Two

This question carried 25 marks and was set around a salaried individual who also received share from an association of persons (AOP) and also derived Income from Property.

The question was generally very well attempted. Mistakes found in different scripts are discussed here.

i. Share from AOP

Many candidates taxed share received from an AOP. However, it was exempt from tax but was to be taken into consideration only for determination of the applicable rate of tax.

ii. Perquisite representing accommodation

A number of candidates did not calculate correct value of the perquisite provided to Mr. Rizwan by his employer in the form of accommodation. Since Rizwan was entitled to 60% house rent allowance, had he not been provided with the accommodation, 60% of his basic salary was to be treated as taxable perquisite at Rs. 720,000. In this case treating the fair rent of the accommodation was not the correct treatment. [S. 13(12) read with rule 4 of the Income tax rules, 2002]

iii. Income from property was to be taxed as a separate block of income, also known as 'fixed tax regime'. The amount was given in dollars; it was to be converted into Rupees at the State Bank of Pakistan rate prevailing on the day the amount was received i.e. on 1 July 2012 and not on basis of open market rate. [S. 15 & S. 71]

Note: Future candidates are advised that with effect from the tax year 2014, income from property shall not be treated as separate block of income. Also deductions as per section 15A shall be allowed, instead of taxing the gross amount of tax, and the resultant income shall be added to income of the other heads of income to reach at total income.

Question Three

Part (a) Immunity from enquiries into the nature and sources of amount invested in shares

Most candidates didn't seem to be aware of the immunity from enquiries into the nature and sources of amount invested in shares. The concession was given in Finance (Amendment) Ordinance, 2012 on 24th April, 2012 which was re-enacted without any change by the Finance Act, 2012. The conditions for availing these concessions were as follows:

(1) the investment is made any time between 24 April 2012 and 30 June 2014;

(2) the amount remains invested for a minimum period of 120 days in the prescribed manner;

(3) tax on the capital gains, if any, is discharged in accordance with the rules provided in the Eighth schedule to the Income Tax Ordinance, 2001; and

(4) a statement of investments is filed with the Commissioner Inland Revenue along with the return of income and wealth statement for the relevant tax year within the due date as provided in the law. [s. 118]

[Rule 2(2) of the 8th Schedule]

Part (b) Mistakes found in some of the scripts are the same as in the scripts of the previous sessions. Future candidates are again reminded that:

i. Definition of securities should be kept in mind and capital gain on their disposal is to be treated as a separate block and taxed at the rates applicable to each security based on its period of holding by the taxpayer.

ii. Taxable gain on disposal of capital assets, other than securities, is required to be reduced to 75% where such asset is disposed of after more than one year. A few candidates did not keep this aspect in to consideration while computing taxable gain leading to wrong computation.

With effect from the tax year 2013, a gain on the disposal of immovable capital assets has also been made taxable. Capital gain on disposal of such assets is to be taxed as a separate block of income at the prescribed rates.

Question Four
This question carried 15 marks and covered different important areas of the income tax law. Answers of the majority of the candidates were found either incomplete or incorrect as discussed below:

Part (a), carrying four marks, dealt with differences between direct and indirect taxes. Many candidates could not answer it correctly that a direct tax is one which is demanded from the very person, who it is intended or desired should pay it, whereas an indirect tax is one, which is demanded from one person in the expectation and with the intention that they shall pass on the burden of the tax to another person, ultimately to the end consumer of the goods or services.

Part (b), carrying four marks was about record keeping and penalty for not keeping the requisite records.
Records are required to be maintained for six years. However, where any proceedings are pending before any authority or court, the taxpayer is required to keep the records until the final decision of the proceedings. [s. 174(3)]

Part (c) carried three marks.
Many candidates were not aware of the powers of the Federal Board of Revenue (FBR) to exempt any person or class of persons from payment of the whole or part of any penalty or default surcharge payable under the Income Tax Ordinance, 2001. The exemption is published in the official Gazette of Pakistan, giving reasons for exemption and terms & conditions for the exemption, if any. [s. 183]

Part (d) carried four marks and was about revision of a return of income. Reply was found satisfactory in majority of the scripts. No approval of the Commissioner Inland Revenue (CIR) was required to revise the return. This point was not answered correctly by some of the candidates.

Note: With effect from 1 July 2013, a taxpayer who intends to revise his return will have to get prior approval of the CIR. [Finance Act, 2013] The changed law will be examinable in the examination sessions starting from June 2014.

Question Five

Part (a), carrying seven marks, involved computation of tax liability for a tax period. Some candidates treated supplies against international tender as zero rated, whereas they were exempt from tax; which led to wrong computation of admissible input tax. Majority of the candidates was found not to be aware of the correct treatment of the input tax paid on the fixed assets. Future candidates should note that with effect from 1 July 2011, input tax on fixed assets is allowable fully in the tax period the input tax is paid. Further, the restriction on the adjustment of input tax in excess of 90% of the output tax does not apply in the case of fixed or capital asset. [Proviso to s. 8B]

Part (b) carried three marks and tested candidates' knowledge to recognise 'time of supply' in the given three situations. Majority of candidates, who attempted this part, achieved full marks.