



Examiner's report

F6 Taxation (PKN)

June 2014

General Comments

The examination paper consisted of five compulsory questions. Question one for 30 marks and Question two for 25 marks, dealt with income tax affairs of a company and an individual, respectively. Question three, carrying 20-marks, related to the computation of capital gains and tax thereon. Question four, having 15 marks, dealt with 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 questions were left unanswered by a candidate, this appeared to be due to a lack of knowledge of the subject. Many candidates got good marks. A few scripts were very impressive. Analysis of the scripts which fell short of the pass mark indicated that full questions were not attempted. Candidates for this paper are expected and advised to study their syllabus guide and prepare for the examination accordingly, leaving no core area of the syllabus unprepared. Further, amendments brought about in the latest Finance Act should also be kept in mind while preparing for their examination. In December 2014 session, the latest Finance Act to be examined will be the Finance Act, 2013. Candidates sitting in June & December 2015 sessions are expected to know and apply amendments brought about in the Finance Act, 2014 insofar they relate to the syllabus areas.

Note: Candidates should make sure that they are preparing for the same Variant of F6 for which they have applied for in their examination documents.

Specific Comments

Question One

Question one was about the income tax liability of a listed company eligible for tax credit for becoming and remaining listed on Karachi Stock Exchange ('KSE') in the tax year 2014. This question was very well attempted by the majority of candidates.

A few common mistakes found in different scripts are discussed below:

Part (a)

Computation of taxable income

- i. Compensation from Sui Southern Gas Company Ltd – Rs. 250,000
Compensation received on account of loss of income due to disruption of the production process is revenue in nature and is covered in the definition of income. No adjustment was required in the computation of taxable income. Some candidates deducted it from the total income incorrectly while others added it back erroneously without realising that it was already included in the income.
- ii. Non-deduction of tax from profit paid to bank – Rs. 2,480,000
Many candidates added back this amount for non-deduction of tax. However, being payment of profit to a banking company as defined in the Ordinance was not subject to the withholding tax provisions. Hence, the amount of profit paid was fully admissible [s.151(1)(d)].
- iii. Capital loss brought forward from the tax year 2012 – Rs. 3,500,000

A number of candidates incorrectly set off brought forward loss from the tax year 2012 against income from business of the tax year 2014 whereas it could have been set off against capital gains only [s.59(2)] which did not accrue to the company during the tax year 2014.

- iv. The total eligible pre-commencement expenditure incurred by the company before 1 July 2011 was Rs. 600,000. It was to be amortised at 20% per annum [information was also provided in the introductory pages of the question paper itself] at Rs. 120,000. The claimed amount of Rs. 200,000 was in excess by Rs. 80,000 which was to be added back. Some candidates added back wrong amounts.
- v. A common mistake on the taxable gain on sale of the motor vehicle was non-restriction of sale proceeds to Rs. 2,250,000 which was required in this case due to restriction of cost of the vehicle [Rs. 3,000,000] to Rs. 2,500,000 for tax depreciation purposes in the tax year of its purchase.
- vi. The value of land owned by the company was revalued upwards and the notional gain of Rs. 5,000,000 had been credited to the income statement which was to be deducted to arrive at taxable income as only real income is chargeable to tax. [s.2(29) and general principles of taxation] A few candidates lost sight of this principle and taxed is incorrectly.
- vii. Another common mistake was deduction of the wrong amount of intangible to reach taxable income. Its cost was to be amortised over the useful life computed in number of years. Further, where an intangible was used only for a part of the tax year, the amount to be amortised was to be restricted proportionately on the basis of the number of days it is used in the tax year. Some candidates did not take into account this aspect and computed wrong amount of admissible deduction.

Part (b)

This part was attempted quite well by a majority of candidates but many did not compute the tax credit at 15% of the tax payable on account of its listing during the year on KSE. Some candidates applied wrong rate of tax despite the fact that the rate was given in the introductory pages of the question paper itself.

Question Two

This question carried 25 marks and was set around a non-salaried individual who derived mainly rental income on account of -

- a. a building which was assessable under the head , "Income from property"; and
- b. a building along with plant and machinery therein, assessable under the head, "Income from other sources."

As admissible deductions are different for heads of income, their correct recognition was essential for a correct answer and earning good marks. Common mistakes noted in the scripts are discussed below:

Part (a)

A number of candidates erred in not appreciating the correct legal position according to which if a building is rented out together with plant and machinery, the rent received or receivable from it is chargeable to tax under the head 'Income from other sources' [s.39(1)(f)] against which no repair allowance is admissible.

Part (b)

In computing income from property, it is to be kept in mind that only deductions listed in section 15A of the Income Tax Ordinance, 2001 are allowable. No other expenditure, howsoever essential for the earning of income, if not listed in s.15A, will be admissible while computing income under the head, "Income from property". Common mistakes noted in different scripts were:

- i. One-tenth of non-adjustable advance taken from the new tenant at Rs. 1,500,000 was taxed by many candidates without first deducting Rs. 200,000 of the non-adjustable advance taken from the previous tenant and which had been taxed. Thus the correct amount to be taxed during the tax year 2014 was Rs. 130,000 $[(1,500,000 - 200,000) \times 1/10]$ and not Rs. 150,000.
- ii. When computing income chargeable to tax under the head 'Income from property', one-fifth of the gross rent chargeable to tax is deductible as a repair allowance, irrespective of the actual amount spent or claimed for repairs. $(1/5 \times 1,330,000)$ [s.15A(1)(a)]. Some candidates deducted actual repair expenditure at Rs. 120,000 which was not correct.
- iii. Expenditure for preparation of tenancy agreement was not allowable being not listed in the list of admissible expenses under s.15A.

Mr Hassan also earned income under the head, "Income from other sources" on account of renting out his building along with plant and machinery. No repair allowance was admissible against this head of income. A few candidates deducted repair allowance resulting in the wrong answer. Some candidates did not compute initial allowance and tax depreciation on building given on rent along with plant and machinery which was admissible on these assets having been put to use for business for the first time in Pakistan during the tax year 2014. In this case legal fee paid for preparing the rental agreement being in connection with earning of the taxable income was an admissible deduction which some candidates treated as inadmissible.

Part (c)

The tax liability of a taxpayer for a tax year was to be reduced by 50% where all of the following conditions are fulfilled:

- (i) the taxpayer is an individual;
- (ii) the taxpayer is aged 60 or more on the first day of the tax year; and
- (iii) their taxable income for the tax year does not exceed rupees one million. [Cl.(1A) of Pt. III of the 2nd Sch.]

Some candidates were found to be aware of the first two conditions only and not the third one, resulting in the wrong answer.

Question Three

This question was answered fairly well by most candidates. The following mistakes were found in different scripts which should be avoided by candidates to get good marks on any question set on capital gains:

- i. **Sale of house in Lahore**
While the majority of candidates calculated correct amount of capital gains, a number of candidates computed correct amount of capital gains but either treated it exempt or treated it as part of total capital gains which was incorrect. Capital gain on immovable property is taxable as a separate block of income at the prescribed rates which are given in the introductory pages of the question paper itself.
- ii. **Compulsory acquisition of land**
Some candidates computed and taxed capital gain on land acquired by the Government of Punjab. Since the consideration received for its disposal was reinvested by the recipient in an asset of a similar kind within one year of the disposal, no capital gain was to be recognised. [s.79(1)(d)]
- iii. **Two paintings were disposed of during the year, one resulting in a capital loss and the other in capital gain.** While a capital loss on a painting was not admissible as a deduction, the capital gain was taxable. Some candidates were not aware of this distinction.
- iv. **Gain on sale of shares in Reliable Energy Limited was not taxable being securities held for more than one year before disposal.** A few candidates wrongly taxed the capital gain arising from disposal of these securities. [s.37A read with Div. VII of part I of the 1st Sch.].
- v. **Many candidates were found not aware of the legal position that the tax credit of Rs. 25,000 allowed in respect of the investment in the shares in Reliable Energy Limited in the tax year 2012 was to be reversed and added back in calculating the tax liability for the tax year 2014 as Ruby had made a disposal of these shares within 24 months of the date of their acquisition** [s.62(2)].
- vi. **Where an asset [other than immovable property or security is disposed of after holding it for more than one year, the capital gain is to be reduced to 75%. Unawareness of this parameter results in incorrect computation of taxable capital gain and tax thereon.**

Question Four

This question carried 15 marks and was mostly narrative in form. The majority of candidates either did not attempt this question [except part (b)] or the attempt was not upto the mark on the points discussed below:

Part (a), carrying five marks, dealt with the circumstances under which a deemed assessment can be amended by the Commissioner Inland Revenue.

Part (b), carrying five marks was generally attempted very well.

Part (c) carried two marks and was to test the knowledge of candidates about the powers of the Federal Board of Revenue (the "FBR") to select either persons or class of persons for audit of their income tax affairs by one of the following two methods:

- (i) selection through computer ballot on a random basis; and
- (ii) selection through computer ballot on a parametric basis [s. 214C(1)]. The FBR may keep the parameters confidential, if it so deems fit.

A large number of candidates did not answer this straightforward narrative part of the question.

Part (d) carried three marks. The vast majority of candidates did not attempt it correctly. Candidates should note that under section 171 (1) , where a refund due to a taxpayer is not paid within three months of the date on which it becomes due, the Commissioner Inland Revenue is duty bound to pay compensation at 15% per annum, of the amount of the refund for the period, reduced by the three months, during which the refund is not paid. Where the refund is created as a result of an appellate order, the refund is said to become due on the date on which the appellate order is received by the Commissioner [s.171(2)(a)].

Question Five

Part (a), carrying three marks was about the function of an e-intermediary and its joint and several liability in certain cases. The reply was vague in most of the scripts. An e-intermediary's function is to file returns, declarations and other documents, etc electronically on behalf of the registered person [s.52A(2)].

Where an e-intermediary, authorised by a registered person, knowingly and willfully submits false or incorrect information or documents or declaration with the intention to avoid payment of the due amount of tax or to claim a refund or a tax credit which is not due to the taxpayer, such an e-intermediary shall be jointly and severally responsible for recovery of the amount of tax underpaid or the excess amount refunded as a result of such incorrect or false information or documents or declaration. [s.52A(5)].

Part (b), carrying seven marks required computation of the sales tax liability of a registered person along with explanation about the treatment of creditor payable given in the question. Answers of many candidates about this treatment of creditor payable were not correct. Creditors payable as at 31 May 2014 included Rs. 580,000 (inclusive of sales tax at 16%) on account of purchases of raw materials from a registered supplier made on 15 November 2013. The input tax on these purchases was claimed in the monthly sales tax return of November 2013. As credit purchases of Rs. 580,000 remained unpaid on 31 May 2014, the input tax previously claimed on this amount was to be reversed ($\text{Rs. } 580,000 \times 100/116 \times 16\% = \text{Rs. } 80,000$). [s.73(2)]