

# Examiner's report

## F6 Taxation (PKN)

December 2012

### 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, mainly covered capital gains. Question four having 15 marks examined different areas of the syllabus and was narrative. Question five was set on sales tax and carried 10 marks.

The majority of candidates attempted all five questions, and there was no evidence of time pressure. Where any question was left unanswered, it appeared to be due not knowing the reply, as evidenced more from question four. Overall performance of the candidates indicated reasonable knowledge of the level required at this stage. Many candidates got good marks. Analysis of the candidates who fell short of passing marks indicated that they had not attempted all questions which lead to the inference that they might not have covered the entire syllabus. The future candidates are also advised to keep in view the amendments made in the latest Finance Act examinable in the paper given in the syllabus guide.

### Specific Comments

#### Question One

Question one was about the income tax liability of a private limited company resident in Pakistan. Most candidates got good marks in this question. However, scripts which could not obtain good marks showed the following mistakes:

#### Part (a)

##### Computation of taxable income

- i. The question contained the figure of 'profit before tax' and it was explained that the same was arrived at after deducting a number of expenses. Expenses which were not allowable were to be added back. However, expenses which were allowable fully were not to be included in the computation of total income and only an explanation was to be given. However, some candidates again deducted these admissible amounts from the given figure of 'profit before tax' which resulted in double deduction. Future candidates should keep this aspect in mind so that they arrive at the correct taxable income.
- ii. A number of candidates seemed not to know the exact tax treatment of the transaction involving the sale of the office building. The accounting gain on the sale of the office building (like any other fixed asset) was to be deducted from the declared income and the taxable gain assessable under the head "Income from business" was to be added back [under section 22 (8)(a) read with section 22(13)(d) of the Income Tax Ordinance, 2001 (the 'Ordinance')]. Further, where the consideration received on the disposal of an immovable property, which has been used for business, exceeds its cost, the consideration received is to be treated as the cost of the property and the tax written down value is worked out from this figure. Many candidates did not keep this aspect of the question in mind while calculating the taxable gain, leading to an incorrect computation.
- iii. Share deposit money was obtained in cash. It was, therefore, to be treated as 'Income from other sources' [under s. 39(3)].
- iv. Some scripts contained mistakes in the calculation of tax depreciation. The value of the asset and rates [although given in the question paper] taken for depreciation were not correct.

## Part (b)

A few candidates did not give credit for the tax deducted at source while computing the tax liability in part (b) of the question and lost, otherwise very easy, marks.

### Question Two

This question carried 25 marks and was set around a salaried individual who also derived income falling under the Final Tax Regime ['FTR']

The question was generally well attempted. Mistakes found in different scripts included:

i. Medical allowance at 15% of basic salary

Some candidates taxed the whole amount whereas only the amount exceeding 10% of the basic salary was to be taxed. [under Cl. (139) of Pt. I of the Second Schedule]

ii. Perquisite representing car

Since the car was being used both for personal as well as official use, only 5% [and not 10%] of the fair market value of the car taken on the finance lease by the employer was to be treated as a taxable perquisite of the employee. [s. 13(3)]

iii. Encashment of recreational leave

Encashment of recreational leave is a taxable perquisite [under s. 12(2)(a)] Some candidates incorrectly treated it as exempt from tax.

iv. Laptop having fair market value of Rs. 140,000

The full fair market value of the laptop given to the taxpayer was to be treated as a taxable perquisite. [under s. 12(11)]. Many candidates taxed only a certain percentage of the fair market value which was not the correct treatment as the ownership of the asset was fully transferred to the employee during the tax year under consideration.

v. Income from Commercial imports

Tax collected at the import stage was to be treated as the final tax on the income arising from the trading of imported goods. Many candidates did not treat this item correctly and worked out taxable income and applied normal tax rates.

vi. Employee share scheme

Ms Fauzia had received 50,000 shares at Rs. 10 per share against the fair market value of Rs. 30 per share on 1 January 2008 with a restriction to sell the shares on or after 1 January 2009 on which date the fair market value was Rs. 40 per share. All the shares were sold on 1 April 2012 at Rs. 50 per share.

Many candidates computed an amount as a taxable perquisite under the head 'salary'. However, the correct treatment was that it was to be assessed as 'capital gains' and the amount spent on acquisition

(Rs.500,000) and the amount treated as salary (Rs. 1,500,000) in the tax year 2009 were to be deducted as cost of the shares in the tax year 2012. Hence, the capital gain was Rs. 500,000. Since the shares were sold after being held for more than a year, only 75% of the capital gains [Rs. 375,000] were liable to be taxed as capital gains.

### Question Three

This question was mainly set for the calculation of capital gains and carried 20 marks. The question was answered very well by the vast majority of candidates.

However, a few mistakes found in some of the scripts are discussed below:

- i. Some candidates did not distinguish between the capital gain on 'securities' assessable as a separate block and the capital gain on other assets leading to the wrong computation of taxable capital gains and tax payable thereon.
- ii. The taxable gain on the disposal of capital assets, other than securities, is required to be reduced to 75% where such an asset is disposed of after more than one year. A few candidates did not keep this aspect in view while computing taxable gain, leading to the wrong computation of taxable gains.
- iii. A few candidates taxed the gain on the sale of the residential house which was not taxable during the tax year 2012. However, in the Finance Act, 2012, the law has been changed. The candidates sitting in the 2013 examinations are advised to familiarise themselves with the changed provisions of the law.
- iv. The loss on the sale of the rare manuscript is not recognised under the law. Some candidates wrongly set off this loss against capital gains realised on other assets. [s.37(5)(d) and 38(5)(c)].
- v. Gift of an antique  
A few candidates taxed the capital gain on the gift of an antique by the taxpayer to his nephew who was resident in Pakistan. However it was exempt under the law. [s.79(1)(c)]

### Question Four

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

Part (a), carrying three marks, dealt with differences between tax evasion and tax avoidance. A number of candidates answered it correctly. However a few candidates could not differentiate between the two. Tax evasion is illegal and is visited with penalties and prosecutions. It involves actions like concealment of facts, misstatement of facts to evade a tax liability otherwise due under the law. Tax avoidance, on the other hand, is perfectly legal and admissible way of reducing a tax liability by using tax deductions, credits, tax reductions, or other beneficial options given in the law.

Part (b), carrying five marks, was about the advance ruling facility available to non-resident taxpayers in Pakistan. Very few candidates answered this part completely and correctly. Its sub-parts are discussed below:

Sub-part (i) tested knowledge about the procedure to obtain advance ruling by a non-resident person. The application is to be made in writing to the Federal Board of Revenue ('Board'). The application must contain a

full and true disclosure of the nature of the material aspects of the transaction about which the advance ruling is desired and the Board gives its ruling thereon.

Sub-part (ii) was about the recognition of the fact that an advance ruling is not binding on the non-resident taxpayer. However, it is binding on the Commissioner Inland Revenue provided that the transaction is carried out in accordance with the all material aspects described in the taxpayer's application through which the ruling of the Board was obtained.

Sub-part (iii) carried one mark for identifying the correct proposition of law that in the case of any inconsistency between a circular and an advance ruling, the latter is to prevail over the former.

Part (c) carried four marks.

A resident individual taxpayer is required to file his/her wealth statement when the individual's last declared or last assessed income or income declared in the current year is Rs. 1,000,000 or more. Sub-part (i) tested this knowledge. However, the majority of the candidates could not give the correct answer. Future candidates should realise that tax compliance is an important area of their syllabus and merits their proper attention.

Many candidates did not attempt sub-part (ii) which was about the filing obligation of a non-resident taxpayer. In the case of non-residents, an individual taxpayer who pays Rs. 35,000 tax under FTR or is asked by the Commissioner through a notice in writing is required to file a wealth statement.

Part (d) carried three marks.

Two points which were not answered correctly are explained below:

- i. It may be noted that genuine loans taken from known persons through admissible modes like crossed cheque and crossed pay order are not to be deemed as income. Some candidates treated it as income which was not correct. [s. 39(3) and s. 111]
- ii. A gift received in cash, however, is liable to be treated as deemed income [s. 39(3)]

#### **Question Five**

Part (a), carrying six marks, involved the computation of tax liability for a tax period. The majority of candidates solved this question correctly. However, a few candidates computed output tax on exempt supplies also and others applied a 16% rate of tax on supplies against the international tender whereas these were zero rated supplies.

Part (b) carried four marks and tested candidates' knowledge and ability to differentiate between exempt supplies and zero rated supplies. The majority of candidates got good marks for this part too. No output tax is charged on the exempt supplies and no input tax is allowed against the exempt supplies. In the case of zero rated supplies, output tax is charged at zero percent and input tax is allowed. A person making zero rated supplies is required to be registered and issue sales tax invoices. A person who is making exempt supplies only does not need to get registered under the Sales Tax Act, 1990 and is not authorised to raise sales tax invoices for such supplies.