



Examiners' report

F6 Taxation (IND)
June 2008

The paper consisted of five questions, all of which had to be answered by the candidates. The first two questions were on practical application of the provisions of income tax law and procedure to real situations – requiring the candidates to ascertain the taxable income and the taxes payable by a non-corporate and a corporate entity. These two questions carried the majority of marks of the paper – 55%. Therefore if candidates struggled with these questions, this could certainly have resulted in the non-obtaining of an overall pass mark. The other three questions carrying 15 marks each were from the various aspects of tax compliance and procedural aspects, though in part they also contained some computational aspects.

Overall performance of the candidates was poor. It was found that many of the candidates struggled with the basic procedure in regards to computation of income and failed to achieve many valuable marks in the process. Traditionally, the two computational problems carrying 55 marks start off with the profit or loss of a business or an individual and clearly indicate that in the ascertainment of that profit or loss, various claims, reliefs and expenses had been adjusted. Details of some of those adjustments to the profits (losses) were singled out for treatment/discussion about their eligibility or otherwise for tax deduction or relief. In many cases, while candidates did exhibit a knowledge of this fundamental procedure, in a significant number of cases, candidates confused themselves and adjusted the figures for claims or otherwise in the wrong manner. Candidates must be aware that each of the adjustments specially listed in the question for treatment carried individual and specified marks and in cases of wrong approach or incorrect adjustments, marks would not be obtained. Candidates should also remember that if they could indicate as part of their answers, the specific provisions of law or any court decision that supports their views and conclusions, full marks would be granted.

As for questions 3, 4 and 5, many candidates could tackle the capital gains computation (question no.3) with a confidence which was lacking when it came to answer questions 4 and 5. These questions were on certain fundamental principles of taxation and performance was disappointing.

I now proceed to evaluate the performance of the candidates in the sequential order of the questions set.

Question 1

This question sought to test the candidates' familiarity with the areas of computation of income under the various headings salaries, profession and other sources. The individual was stated to be a person who retired from government service midway through the year receiving as every government servant does, retirement benefits such as return of provident fund contributions, gratuity, insurance sums, etc. The point to remember in this case was that while the law prescribes certain limits with regards to gratuity and leave encashment receipts by private sector employees, in the case of government servants, the entire entitlement and receipts are totally tax free. Many candidates did not remember this. Again, in the case of government servants, granted accommodation and conveyance facilities where a sum of money is recovered from the government servant for use of the asset, no perquisite is included in the individual's income.

A part of this question dealt with professional income in two parts – one as an individual professional play back singer and the other as a management consultant in a firm in which his brother was a partner. As regards "singing", though many of the answers were satisfactory, in some cases, candidates did not calculate correctly the depreciation benefit on certain assets. The tests required to be satisfied by the candidates were on the rate of depreciation allowable (the rates had come down recently) and the quantum due dependant on the period of use – more or less than 182 days in the year. Many of the answers, subject to minor glitches referred to above, were of a good standard.

As regards the consultancy part, some candidates forgot to note that the share of profits given in the question was only 50% of the firm's profits whilst the adjustments required to be done were the firm's. Some of the answers did not bring out the fact that a partner's share of profits in a firm is not taxable in his hands – see sec.

10 (2A). Only interest on capital allowed as a deduction in the hands of the firm, had to be taxed in the hands of the partner.

Computation of income under the heading 'other sources' again showed some weakness in understanding of the law by the candidates. Gifts from a close relative on occasions of marriage, etc. are not to be included in income under s. 56(2)(vi).

The liability of the individual to go through the process of a tax audit was referred to by only a small number of candidates. The type of accounts to be maintained by the individual under sec. 44 AA was again only known by a small number of candidates. Many candidates referred to the non-liability to surcharge on income tax in cases where the individual's income did not exceed Rs.10,00,000, however this was not the case when it came to the matter of interest on non-payment of advance tax.

The general answers to this question can be categorised as "satisfactory."

Question 2

This question was on the computation of income of a company. Here again, a series of claims was listed in the question, and candidates were required to explain their treatment. The performance, however, was disappointing.

The adjustments stated covered areas such as enhanced allowances for research activities under s. 35(2AB), a claim under s. 41(1), disallowances under s. 40 and 40A(3) (where the law has been recently changed for the total disallowance of the claim and not only a part), s. 37 and s. 80 GGB (allowance of donation to a political party), etc. Performance was disappointing. In the computation of tax due, some candidates did not remember the fact that no surcharge on tax was payable by a company unless its income exceeded Rs.1 crore.

Question 3

This question on capital gains was principally meant to test the candidates' knowledge of different yardsticks to be adopted for long and short term gains. Information was given in the question to enable the candidates to split the transaction of the sale between sale of land and sale of the super-structure, which many candidates picked up on.. Many candidates did not remember the non-application of inflation index to short term capital assets; and many treated the leasehold transaction as a business one and not transfer of a capital asset – which it was.

The level of performance of the candidates was average.

Question 4

This question was in two parts – the first and the most significant one dealt with the concept of deemed dividends – under s.2(22)(e) of the Act. Many candidates displayed a disappointing knowledge of this subject. The important points to be remembered in this connection were that there should be accumulated profits in the hands of the company and the registered shareholders of the company should be favoured with advances. Even if advances were to be returned in the same accounting year, they will still be deemed as dividends to the extent of accumulated profits etc. Many students struggled with this. Whilst there would be an effect in the hands of the registered shareholders where the loans advanced or the amounts drawn would be treated as dividends taxable in the hands of the shareholders (not exempt under s. 10(38)), the company may not have to pay any dividend distribution tax because of the provisions of s. 115 (O).

The second part was attempted by many candidates but the answers were only partly correct. Situations like s. 174(6), 174 and 175 had to be covered in the answer.

Question 5

This question, divided into three sub-divisions of five marks each, was attempted by many but with disappointing results.

The first part dealt with the principle of mutuality for a club dealing with its members. This principle is based on the premise that no person can make a gain out of himself. The structure of the organisation itself was not relevant but the way in which it functioned.

The second part dealt with s. 205 where a tenant had deducted tax yet defaulted in paying the tax to government. The tax deducted at source by him from any payment cannot be enforced against the tax payer.

The third part dealt with the basic concept of diversion of income by over-riding title. In other words, that income does not accrue to the business at all, and so does not belong to the tax entity, and has to be recognised and appropriated even at the threshold.

None of the three parts were handled satisfactorily by the candidates though some marks were gained.

General

Overall, it is disappointing not to see more in-depth knowledge of the principles and practice of Indian taxation, and to see some candidates struggling with the basic principles. The number of candidates taking this paper is steadily going down.