

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN	
EXAMINERS' COMMENTS	
SUBJECT Advanced Taxation	SESSION Certified Finance and Accounting Professional (CFAP) Examination - Summer 2018

General:

The examination consisted of seven questions with question numbers 1, 2(c), 3 and 5 based on computational skills entailing 57 marks whereas the rest were essay based questions comprising 43 marks. There was slight improvement in the overall performance as the passing ratio was 13.9% as compared to 11.9% in the previous attempt. However, even this percentage reflects a very poor performance. Especially, the performance was very poor in question 2 and 4 as quite clearly, many students had skipped that part of the syllabus, which was tested in these questions.

Candidates are advised to pay special attention to the requirement of the question. Some students present too much detail unnecessarily which results in wastage of time and brings the students under pressure in responding to those questions, which are attempted in the latter part of the examination.

Question-wise comments are as under:

Question 1

This question required candidates to compute, under correct head of income, the total income, taxable income and net tax payable by or refundable in case of a private limited company named RPL. The performance was not satisfactory as only 27% candidates could secure passing marks. Following mistakes were observed in most of the answer scripts:

- The export of milled limestone and marble was treated under FTR and common expenses were apportioned between NTR and FTR despite the fact that RPL had opted out of the final tax regime.
- Export of IT services of Rs. 1,800,000 was considered to be exempt. In some cases it was treated as business income instead of other source income.
- Fee for technical services amounting to Rs. 540,000 was ignored.
- Mark-up of Rs. 60,000 on borrowed capital was also ignored.
- While computing gain on sale of securities in FL, majority of the candidates did not appreciate that under Rule 13P of the Income Tax Rules, 2002 the cost of shares received as specie dividend is to be taken as zero.
- In some instances, instead of computing tax credit on donation of Rs. 5,150,000 spent for the construction of a library building under RPL's CSR scheme, the entire amount was treated as admissible deduction. Those who computed tax credit failed to comprehend that the amount of donation was to be restricted to 20% of the taxable income excluding income covered under FTR.

- While computing net tax liability, most of the candidates ignored the following:
 - Adjustment of advance tax of Rs. 680,000 paid u/s 154 on realization of 80% of the export proceeds. This amount was to be treated as minimum tax as RPL had opted out of FTR.
 - Amount of tax chargeable on the undistributed profits of RPL. This tax was required to be paid by RPL as it did not distribute at least 40% of its after tax accounting profit through cash/bonus shares. [requirement of section 5A of the Income Tax Ordinance, 2001]
 - Adjustment of technical fees of Rs. 540,000 and withholding tax on technical fees of Rs. 81,000, for the purpose of computing accounting profit.
- Despite that candidates were asked to ignore the computation of WWF, WPPF, minimum tax u/s 113, Alternative Corporate tax (ACT) and default surcharge, many candidates wasted precious time by unnecessarily computing minimum tax, ACT and default surcharge.

Question 2

This question carrying 17 marks was divided into three parts. The overall performance was quite poor as only 6% of the candidates managed to score passing marks whereas only 19% of the candidates could secure 6 or more marks. The performance on each part is discussed below:

Question 2(a)

This part was further divided into two parts. Part (i) required candidates to briefly describe when a revised return filed by a person u/s 114 is treated as an invalid return. Part (ii) asked candidates to describe the circumstances in which a taxpayer filing the revised return is not required to pay the penalty.

The overall performance in both sub-parts remained very poor. In part (i) majority of the answers were incomplete and were mostly confined to the statement that a return filed after 120 days of filing of original return and without payment of taxes is considered to be invalid.

In part (ii) also, most of the answers were incomplete. Some candidates mentioned that penalty is not required to be paid if it is exempted by the Commissioner-IR/Board/Federal Government. Some candidates stated that no penalty is payable if revised return is filed before completion of the audit by the tax department, whereas according to the Ordinance the requirement is that the revised return should have been filed before receiving notice calling for audit. Many candidates also deliberated on the situations where a taxpayer is required to pay either 25% or 100% penalty with the return, which was not required by the question.

Question 2(b)

In this part, the candidates were required to describe the term 'MNE group' in relation to the country-by-country reporting requirement. The performance on this part remained very poor and majority of the candidates left this part un-answered. Those who attempted the question resorted to guesswork. Many candidates mixed up the concept of MNE group with group taxation. Most of the answers were only confined to the statement that MNE group includes two or more entities.

Question 2(c)

This part required the candidates to calculate the taxable income of a private limited company (PPL) having property income. The performance on this part remained good and majority of the candidates secured passing marks. However, some candidates were of the opinion that since the income has been derived from agricultural land it is exempt from tax. Many candidates also considered repair expenses at the rate of 1/5th of rental income, insurance premium and accrued interest as admissible deductions without realizing that repair expenses and insurance premium are not available on land and interest is deductible only when payment is made.

Question 3

It was a comprehensive question on group relief and required candidates to compute under correct head of income, the taxable income and tax payable by or refundable to a private limited company (HL) which was also the holding company of a group of companies, under two different scenarios. One, when HL's holding in one of its subsidiary AB was 70% and second, when it's holding was 98%. Candidates were required to give reasons for the treatment of losses to be surrendered by AB in favour of HL under the above scenarios. Candidates were also asked to state the amount of cash, if any, which HL would be required to transfer to AB with the approval of the board of directors.

This question was reasonably well attempted as around 46% of the candidates secured passing marks. Some common mistakes observed were as follows:

scenario (a):

- Royalty income, though exempt, was treated as business income.
- Profit on debt was not reclassified under other source income.
- 70% of AB's eligible losses were surrendered in favour of HL whereas losses cannot be surrendered if holding is less than 75%.

scenario (b):

- Loss on sale of manuscript and brought forward losses were added to AB's assessed loss of Rs. 9,800,000 for computing the amount of loss to be surrendered in favour of HL.
- Losses were surrendered against taxable income instead of business income.
- The entire loss was surrendered without realizing that losses would be surrendered only to the extent of business income and the excess, if any, would be carried forward for adjustment in the next tax year.
- Gain on sale of immovable property was taxed at the rate of 7.5% instead of 10%.

Question 4

This question carrying 16 marks was divided into four parts. It was the worst attempted question on the paper as only 2% of the candidates secured passing marks. Comments on each part are given below:

Question 4(a)

This part required candidates to identify the persons who may be allowed to import goods or a class of goods without payment of the whole or any part of the tax payable thereon and the authority who may grant such approval.

The performance on this part was unsatisfactory. Most of the answers were incomplete and there were various types of mistakes. Some candidates identified the types of products which may be imported without payment of taxes instead of identifying the persons who may be allowed to import goods without payment of taxes. Majority of the answers were limited to the statement that taxes are not required to be paid in respect of goods which are imported for re-exportation. Similarly, most of the candidates only identified Board as the relevant authority who may grant exemption from payment of taxes in this regard; and did not mention that the same had to be approved by the Federal Minister in-charge also. Some candidates thought that government departments, educational institutions, united nation agencies, foreign embassies etc. can import goods without payment of taxes.

Question 4(b)

In this part, the candidates were asked to identify the persons who may be regarded as withholding agents for the purpose of deduction and deposit of sales tax.

The performance on this part remained satisfactory and most of the candidates secured passing marks. However, while mentioning about recipient of advertisement services and exporters the condition of being registered for sales tax purposes was ignored. Further, some candidates mentioned companies registered under Companies Ordinance, 1984 instead of companies as defined in the Income Tax Ordinance, 2001 (XLIX of 2001).

Question 4(c)

This part required candidates to state the authority who shall determine the risk parameters to be used for balloting in selecting cases for audit on parametric basis and the factors on which audit selection parameters may be based.

The performance on this part remained very poor. Majority of the candidates left this part unanswered. Those who answered, were only able to identify the authority. Some students however mentioned the Commissioner as the authority who determines the risk parameters, instead of the Board. With regard to the factors on which audit selection parameters are based, the answers were either incomplete or based on guess work. Buying or selling from/to a black listed or suspended person, filing of revised return or no return, non-payment or short payment of sales tax, on recommendation of other Commissioner, etc. are some of the factors stated by majority of the candidates.

Question 4(d)

This part was divided into two sub-parts. Part (i) asked the candidates to briefly describe when a taxable service shall be considered to have been provided in a tax period whereas, part (ii) required them to describe the possible actions the Board/Authority is required to take if the suspension of a person's registration is not withdrawn within sixty days.

The performance in part (i) remained satisfactory. However, candidates failed to answer part (ii) correctly. They misconstrued suspension of registration with blacklisting of taxpayer and deliberated that Board/Authority may issue appealable self-speaking order and proceed to take legal action and blacklist the person.

Question 5

This question required the candidates to compute sales tax payable by or refundable to a registered person (RRL) in a given tax period. The performance on this question was not satisfactory as only 20% of the candidates scored passing marks. The common errors were as follows:

Input tax:

- Input tax on goods destroyed by fire was treated as inadmissible. However, under Circular number 1 of 1989 input tax is admissible on such goods.
- Input tax on supply of electric bulbs and telephone sets, designated as specified goods under chapter XIII of the Sales Tax Special Procedure Rules, 2007 was not claimed without appreciating that input tax can be claimed on such goods in case these are supplied by wholesaler-cum retailer.
- Value addition tax on import of agricultural tractors was ignored. Some students considered it as fixed assets purchases.
- In defiance of the provisions of (clause k of sub-section 1 of section 8) of the Sales Tax Act, 1990 input tax was claimed on import of agricultural equipment.

Output tax:

- Output tax was not charged on supply of lubricating oil worth Rs. 1,500,000 to a company under Morabaha arrangement ignoring the fact that such supplies are excluded from the ambit of sales tax only if the transactions are entered into by a banking company or a financial institution. Further, extra tax at the rate of 2% was also not computed on supply of lubricating oil on the same premise.
- Supply of fans of Rs. 700,000 to a company in EPZ was considered as a zero rated supply. Candidates did not appreciate that only raw material and components (not finished goods) supplied for further processing in EPZ are treated as zero rated supplies.
- Output tax on packing machine of Rs. 2,500,000 was not charged considering it a depreciable asset.
- Output tax was not charged on supply of stores worth Rs. 125,000 for consumption on a flight proceeding to Islamabad. Candidates failed to appreciate that supply under such circumstances is treated as zero rated only if the flight is proceeding outside Pakistan.

Others:

- Withholding tax was not computed on purchase of 3rd Schedule items of Rs. 1,280,000 from un-registered suppliers on the ground that such items are not subject to withholding tax Rules. Candidates ignored the fact that provisions of Rule 5 of the Sales Tax Withholding Rules, 2007 are applicable to registered persons only.
- Withholding tax was computed on entire purchases from unregistered supplier despite the fact that goods amounting Rs. 1,065,000 were covered under the Sixth schedule.

- Extra tax was collected on supply of fans to a company in EPZ ignoring the fact that Extra tax is collected either by a manufacturer or an importer of such goods and RRL in this case was neither the manufacturer nor the importer of fans.
- Further tax was collected from a cottage industry ignoring the fact that further tax is levied only on those un-registered persons who are liable to be registered.

Question 6

This question was divided into two parts. The overall performance was unsatisfactory as only 21% of the candidates scored passing marks. Comments on each part are given below:

Question 6 (a)

This part was based on Federal Excise Act, 2005 and required the candidates to briefly describe the circumstances under which a person may be required to pay default surcharge. Candidates were also asked to identify the duration of time which may be considered as a period of default and the rate at which the default surcharge should be paid.

The performance on this part remained unsatisfactory. Majority of the candidates failed to state that the default surcharge is to be paid at the rate of KIBOR plus 3%, per annum. With regard to the period of default, many students thought that the period of default is reckoned from the date of default to the day the duty is actually paid.

Question 6(b)

This part was further divided into two sub-parts. Part (i) required candidates to explain whether Officer of Inland Revenue was justified in issuing the show cause notice to the taxpayer under the circumstances mentioned in the scenario. In part (ii), the candidates were asked to describe the period within which the Officer Inland Revenue must decide the case given in the scenario.

The performance on this part was not satisfactory either. In part (i), majority of the candidates did not write that the notice was to be issued within a period of 5 years from the relevant date i.e. the date on which payment of duty was due. Many candidates were of the opinion that a show cause notice cannot be issued in the given scenario as the goods were supplied to EPZ for in-house consumption. In part (ii), only few students could produce a comprehensive answer.

Question 7

This question was divided into two parts. It was the best attempted question of the paper and approximately 47% candidates secured passing marks. The performance on each part is discussed below:

Question 7(a)

This part required the candidates to briefly describe any three pillars of tax administration which help to safeguard the interest of the tax payers.

The performance on this part was good. However, some candidates confused it with the canons of taxation.

Question 7(b)

This sub-part required the candidates to briefly describe the terms ‘Tax evasion’ and ‘Tax avoidance’.

The performance on this part was average as many candidates mixed-up the two concepts and lost marks.

(The End)