

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

General:

The passing ratio increased significantly to 49% from 13.9% in the previous attempt. The major improvement was seen in the numerical questions as compared to essay based questions which proved to be more challenging for the majority of the candidates. Candidates are advised to pay equal attention to both computational and essay based questions.

Question-wise comments are as under:

Question 1

This question required to compute, under correct head of income, the total income and taxable income of an individual taxpayer. The performance was very good as 86% candidates secured passing marks. Some of the more common mistakes are described below:

- While computing speculation business income, many candidates did not adjust loss of Rs. 430,000 incurred on local speculation business against foreign speculation business income of Rs. 500,000. They did not comprehend that foreign speculation business loss cannot be adjusted against local speculation business income but local speculation loss can be adjusted against foreign business income.
- Brought forward loss on sale of shares in listed company was adjusted against gain on sale of derivative products.
- Return on investment in Sukuks was either not considered or incorrectly taken under the head capital gains.
- While computing income from other sources, Rs. 6,000 being one tenth of the amount of net consideration of Rs. 60,000 (120,000-60,000) received on vacating the possession of a rented building was not considered.
- Agricultural income is exempt from tax and loss on sale of agricultural produce of Rs. 65,000 being ineligible for deduction, was to be added to the income from other sources. However, in many instances, instead of adding the amount, it was deducted from other source income.
- Tax credit was incorrectly claimed on tuition fee in spite of the fact that taxable income of the assessee was more than Rs. 1,500,000.

Question 2

This question was primarily based on the requirements of thin capitalization and required candidates to compute the taxable income and net tax payable by or refundable to an unlisted public company, Empress Limited. The overall performance was reasonable as about 44% candidates scored passing marks. Following common mistakes were observed in many replies:

- Many candidates failed to appreciate that the concept of thin capitalization applies only when interest on debt is either exempt from tax or chargeable at a rate lower than the corporate tax rate. As a result, they subjected both loans to thin capitalization, whereas, thin capitalization was applicable only on loan obtained from Tulip S.A.
- Some candidates treated the whole equity as foreign equity and concluded that interest on loan from Tulip S.A. falls within the prescribed limits of thin capitalization. Consequently, the entire amount of interest was treated as admissible.
- Inadmissible portion of the profit on debt was wrongly allocated to incomes from all sources whereas the debt was only related to local operation of Empress Limited.
- As provision for bad debts is inadmissible for tax purposes therefore reversal of excess provision should have been deducted from profit before tax to arrive at taxable profit. Many candidates did not make this adjustment.
- Cost of ramp was a capital expenditure but according to the information given in the question, it had been charged to profit. No adjustment was made to correct this error and the related depreciation.
- Many candidates did not compute minimum tax, alternative corporate tax and Pakistan tax on foreign source income for determining the net tax liability.

Question 3

This question required candidates to describe the five fundamental principles of ethics for tax practitioners.

This question was reasonably well attempted as around 62% of the candidates secured passing marks. Candidates lost marks where they were unable to state all the five principles of ethics.

Question 4

This question with the potential 17 marks was divided into three parts. The overall performance remained satisfactory as about 43% of the candidates secured passing marks. Comments on each part are given below:

Question 4(a)

This part was based on the requirements of sections 182 and 205 of the Income Tax Ordinance, 2001. It required candidates to compute the amount of tax, default surcharge and penalty payable by a private company, Massive (Pvt) limited for late filing of the return.

The performance on this part remained below average. While computing period of default, most of the candidates correctly computed the days of default i.e. 66 days but they either failed to compute the penalty for late filing of return at the rate of 0.1% per day of the amount of tax liability of Rs. 3,600,000 or simply concluded that a minimum amount of Rs. 20,000 would be paid as penalty. Many candidates also failed to compute default surcharge at the rate of 12% of the amount of tax short paid i.e. Rs. 400,000. Similarly, many candidates did not compute default surcharge for 92 days of default on the amount of tax of Rs. 40,000 which was short paid. This amount was the difference between 90% of the gross amount of tax liability and tax paid u/s 147 of the Income Tax Ordinance, 2001.

Question 4(b)

This part was based on the requirements of Rule 13P(t) of the Income Tax Rules, 2002. According to the situation given in the question, a company TL was demerged into two companies i.e. TL and BL. The candidates were asked to compute taxable income and tax payable by an individual, Ali Murad on sale of shares subsequent to de-merger.

The performance on this part remained average and most of the candidates secured around passing marks. The most common mistake was that the candidates did not appreciate that de-merger was a tax neutral event and computed tax at the time of splitting of TL's shares into TL and BL based on the difference between cost of shares held and market value of shares owned by the taxpayer. Consequently, market values of shares (after de-merger) in TL and BL at Rs. 20 and Rs. 50 respectively were incorrectly considered as the cost. Whereas, as per Rule 13P(t) of the Income Tax Rules, 2006 the cost of both shares should have been taken as Rs. 33 each ($49.50 \times 10,000 / 15,000$). Also a number of candidates did not comprehend that the holding period of securities is to be reckoned from June 30, 2016, i.e. the date of acquisition of 10,000 shares in TL. Accordingly, the tax rate to be used was 7.5%. Candidates wrongly assumed the holding period of shares in BL from the date of demerger and thus applied tax rate of 15%.

Question 4(c)

According to the situation given in this part, an individual had received shares in 2016 under an employee share scheme and he sold these shares in 2018. The candidates were required to compute under correct head of income, the amount to be included in the tax payer's taxable income in tax years 2016, 2017 and 2018.

The performance on this part remained good. Majority of the candidates appeared to have good knowledge of the subject and secured high marks.

Question 5

This question was divided into two parts. The overall performance was unsatisfactory as only 22% of the candidates scored passing marks whereas about 20% candidates did not attempt the question at all. Comments on each part are given below:

Question 5 (a)

This part was based on section 6 of the Federal Excise Act, 2005 and required candidates to explain the determination of net liability of duty in case of sale/supply of own produced aerated waters (dutiiable good) and specify the conditions which are required to be fulfilled for claiming adjustment.

The performance on this part remained unsatisfactory. Majority of the answers were only restricted to the statement that for determining the net liability, the duty already paid on input goods shall be deducted from the amount of duty calculated on aerated waters. Most of the candidates failed to specify the conditions necessary for the admissibility of the adjustment of excise duty.

Question 5(b)

This part was further divided into two sub-parts. Part (i) required candidates to describe the tax treatment of the item (concentrates) used in the manufacture of goods (aerated beverages) exported out of Pakistan. In part (ii), candidates were asked to describe the tax treatment of supplies (edible olive oil) consumed on board a domestic flight.

In part (i), majority of the candidates correctly stated that excise duty shall be payable at the rate of zero percent, however, they failed to cover the issue of duty drawback. In part (ii), with the exception of few, majority of the candidates acknowledged that duty on edible olive oil shall be charged at applicable rates and would not be treated as zero rated goods. However, most of the candidates failed to comprehend that duty in this case would be payable in sales tax mode.

Question 6

This question was divided into two parts. The overall performance remained poor as only 18% candidates secured passing marks. The performance on each part is discussed below:

Question 6(a)

This part was based on the issue of recoupment of head office expenditures and required candidates to discuss the tax treatment in the given scenario.

The performance on this part was poor as majority of the candidates failed to realize that recouped expenditure was not taxable as it was never previously allowed as an admissible expense.

Question 6(b)

This part tested candidates' knowledge of section 101 of the Income Tax Ordinance, which relates to geographical source of income and the relevant provisions of withholding income tax. The candidates were required to explain the tax treatment of the payments made by a resident company to (i) a non-resident debtor for the settlement of a claim lodged on account of supply of defective products and (ii) a non-resident lawyer for making the settlement with the debtor.

The performance on this part was very poor. Majority of the candidates thought that no withholding of tax was required on payment to non-resident debtor as it neither related to the supply of goods or provision of any service. Very few candidates were able to identify correctly that payment to non-resident person, not specifically dealt with in section 101, is to be considered a Pakistan source income, and that withholding of tax has to be made at the rate of 20% except where a permission is obtained from the Commissioner for non-deduction of tax.

As regards payment to non-resident lawyer most of the students stated correctly that the payer was liable to deduct tax and since tax had not been deducted, such expense was not to be allowed as admissible deduction. However, only few candidates were able to comment further that the payer in such a case was personally liable to pay the amount of tax to the Commissioner.

Question 7

This question required the candidates to compute sales tax payable by or refundable to a registered person (DL) in the given tax period. The performance on this question was satisfactory as 52% of the candidates scored passing marks. The common errors were as follows:

Input tax:

- Packing material purchased for use in packing of textile products covered under SRO 1125 dated December 31, 2011 was incorrectly considered as zero rated.
- No input tax was considered on purchase of storage batteries. Candidates failed to appreciate that by virtue of being designated as specified goods under chapter XIII of the Sales Tax Special Procedures Rules 2007 storage batteries are not subject to extra tax if supplied to manufacturers, thus input tax paid thereon was claimable.
- Cooking ranges were wrongly considered to be exempt in the supply chain owing to the levy of extra tax. Whereas in view of Rule 58RA(I) of the Sales Tax Special Procedure Rules, 2007 input tax was claimable on their purchase.
- Input tax credit on import of compressor scrap was wrongly claimed @ 10% of the value of import whereas in view of section 8(1)(m) of the Sales Tax Act, 1990 input tax credit on such purchases is not allowed.
- Value addition @ 3% was charged on import of finished sports footwear whereas in view of Rule 58B(I)(v) of the Sales Tax Special Procedure Rules, 2007 value addition is not payable on such imports.

Output tax:

- The supply of red chillies was considered to be exempt whereas it was not exempt as it was supplied under a brand name in retail packing.
- Sales tax was charged on supply of sugar to Pharma company whereas such supply was exempt.
- Output tax was not charged on supply of cooking ranges based on the fact that extra tax has been paid on it. Under Rule 58RA(I) of the Sales Tax Special Procedure Rules, 2007 output tax was to be charged on such supply.
- The amount of mark-up included in the value of goods supplied on credit was wrongly computed. Please refer to ICAP's suggested answer for further guidance.
- Majority of the candidates proceeded to apportion total input tax on exempt supply of sugar. No such apportionment of input tax was required since the sugar was locally purchased and not manufactured in-house.

Others:

- Withholding was made on purchases from cottage industry. No withholding was required as cottage industries are not liable to be registered.
- Extra tax was charged on supply of cooking ranges.
- Some candidates also withheld tax on import of compressor scrap.

Question 8

This question was divided into three parts. The performance except in part (a), remained poor. On an overall basis, only 18% candidates secured passing marks. The performance on each part is discussed below:

Question 8(a)

This part tested candidates' knowledge of section 59 of the Sales Tax Act, 1990 which relates to admissibility of input tax paid on goods acquired before registration.

The performance on this part remained good as majority of the candidates were aware of the central concept envisaged in section 59 of the Act. However, few candidates were of the view that admissibility of input tax is to be determined with reference to the date of registration instead of date of application for registration. Some candidates incorrectly considered the input tax allocable to unverified stocks of 600 packets of imported fruit juices as admissible.

Question 8(b)

This part required the candidates to determine the value of supply and the amount of sale tax payable in case of purchase of goods covered under the Third Schedule to the Sales Tax Act, 1990.

The performance on this part remained average as the candidates failed to realise that no input tax was required to be calculated on the fork lifter. Being the Third Schedule item, only output sales tax was to be charged on the retail price of Rs. 12,500 (inclusive of FED) irrespective of the amount received or charged.

Question 8(c)

This part was based on the provisions of Provincial Sales Tax on Services Acts and tested the concept of reverse chargeability.

The performance on this part was very poor and majority of the candidates secured low marks. The important point in the question which majority of the candidates failed to clarify was that the Punjab Sales Tax on Services Act, 2012 operates on the principle of both origin and destination, whereby tax is imposed, levied and collected in Punjab if services are either initiated in Punjab or consumed or delivered in Punjab. Therefore, notice issued by PRB was justified on the basis of destination principle.

(The End)