

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

EXAMINERS' COMMENTS

SUBJECT	SESSION
Taxation	Intermediate Examination - Spring 2008

Note: Some of the rules which have been referred to and explained in these comments have subsequently been revised in the Budget 2008.

Q.1 The performance was generally good as most of the students knew that share of income from an AOP is included in the income of its members, for rate purposes only. However, various types of mistakes were also witnessed in the answers even by those students who otherwise appeared to have good overall knowledge. The mistakes generally committed by the students are listed below:

- (i) The fact that Sales included rental income of Rs. 1.0 million was ignored. Consequently, the business income of the AOP was over-stated.
- (ii) Many students taxed the share of income from the AOP in the hands of its members i.e. Saleem, Rashid and Moin.
- (iii) Many students adjusted the loss on sale of car just as if it was a business loss while many others declared that it was a capital loss and could be adjusted against capital gains only. In fact it was a transaction involving a personal asset of Mr. Saleem and had nothing to do with his taxable income.
- (iv) In case of Mr. Rashid, many students correctly treated his share of income from the first AOP as exempt in his hands but included his share of income from the other AOP in his taxable income.
- (v) Many students treated the dividend income of Mr. Rashid as his business income instead of treating it as an income under FTR.

Q.2 (a) The students were required to explain the circumstances under which a personal loan taken by a person, may become liable to be included in his taxable income. Many students started explaining the rules relating to interest on loans received from the employers, whereas it was clearly mentioned in the question that the loan is being taken from a money lender and not from the employer.

Many students resorted to guess work and included the following situations in the answers:

- if loan is interest free
- if the loan is not repaid
- if there is no loan agreement
- if the loan is not used for the purpose for which it was taken

- (b) The question was very simple. Most of the students were able to declare correctly that Mr. Waseem had both the options i.e. to have the arrears of salary taxed with the income of the year in which it was received i.e. 2008 or to have it taxed as part of his income in 2007.

However, very few of the students were able to point out that if he decided to have the arrears taxed in 2007, he will have to make an application to the Commissioner of Income Tax.

Many students referred to the provision which is no more applicable and declared that such receipts will be taxed at the average rate of tax of the last three years.

- Q.3 (a) This question related to a company which had suffered losses during the first year of its operations. Without giving any further details, the students were required to explain as to how the advance tax to be paid (if any) during the next tax year, will be determined. Most of the students gave incorrect and incomplete replies as described hereunder:
- A number of students declared that the Company would not be required to pay any tax. They could not realize that at least the amount of minimum tax u/s 113 will have to be paid as advance tax.
 - Very few of the students could state that if at any time before the last installment becomes due, the company estimates that the amount of tax payable for the year will exceed the tax liability of the previous year, it will have to cover the shortfall in the remaining installments.
- (b) The students were generally able to secure good marks in this question which was based on section 14 of the Income Tax Ordinance 1984. However, the following issues were also witnessed in a large number of answer scripts:
- The students were confused as regards the difference between an option and a share.
 - Many students believed that the gain on sale of shares will be computed on the basis of the sale proceeds instead of their fair market value.
 - Some students who referred to the fair market value, did not mention the date on which such market value will be ascertained.
- (c) The candidates were required to describe the circumstances under which the return of income for a period less than twelve months, may have to be filed. The question was generally well answered; however, the following deficiencies were commonly found:
- Most of the students wrote that persons leaving Pakistan are required to file such a return, whereas only those persons who are leaving Pakistan permanently are required to file such a return.
 - Very few of the candidates mentioned about the power of the Commissioner of Income Tax, to demand such return in any situation where he deems it appropriate to do so.

- Q.4 (a) (i) The admissibility of Bad Debt, as an expense, is subject to the conditions listed in Section 29 of the Income Tax Ordinance 2001. Most of the students were able to list the conditions.
- (ii) Only about 20% of the students could produce a correct and complete answer. Most others made one or more of the following mistakes:
- Stated that the amount will be taxed in 10 years without clarifying that the amount will be taxed in 10 equal installments commencing from the year in which the amount is received and the next nine years.
 - Did not specify the treatment if the amount is subsequently refunded or when another amount is received thereafter.
 - Stated that if the amount is refunded, the amount taxed so far will be allowed as an expense.
 - Stated that the difference between the amount refunded and the amount received from the next tenant will be taxed equally, during the next ten years instead of mentioning that the amount subsequently received less the amount that has already been taxed so far will have to be offered to tax.
- (iii) The mistakes generally noted in the replies were as follows:
- Some students started explaining the different types of speculative transactions, which was not required.
 - Many students declared that gain from speculation business is taxed as “Other Source of Income”.
 - Very few of the candidates could specify that although such gains are also classified as business income yet such business is treated as separate and distinct from any other business.
 - Many students stated that speculation losses are allowable over the next six years. In fact these are not allowable but are adjustable and that too against speculation income only.
- (b) Most of the students were able to list the two conditions referred to in Section 2 (19) of the Income Tax Ordinance, 2001 under which payments made by a private company may be treated as dividend i.e.
- Payment by way of advance or loan to a shareholder
 - Any payment for the individual benefit of any shareholder

However, very few were able to clarify that the amount shall be so classified to the extent to which the company possesses accumulated profits. Similarly, the exceptions to the above rule were not mentioned by many candidates.

- Q.5 (a) (i) Almost all the students secured average marks as they produced partially correct but incomplete answers.
- (ii) Most of the students did specify the formula for calculation of tax credit in its symbolic form i.e. $(A/B) \times C$. However, the following mistakes were usually made in explaining the symbols:
- Most of the students stated that 'A' represents tax assessed without clarifying that it is the tax assessed prior to deduction of any tax credit therefrom.
 - Some of the students described 'C' as the amount of donations without specifying any limits while many others limited these to 15% of taxable income i.e. the rule applicable for companies instead of specifying the limit applicable to individuals i.e. 30%.
- (b) (i) Instead of explaining the treatment of dividend income, a vast majority explained the rules related to deduction of WHT, on payment of dividend.
- (ii) Very few students could explain the main difference i.e. rent upto Rs. 150,000 is exempt in the hands of an individual if he/she does not have any other source of income whereas a company does not enjoy such a benefit.
- (iii) A company has to account for its business income under accrual method only whereas an individual has the option to use cash basis of accounting also. Most of the students were able to spell out the difference correctly.
- (iv) Very few of the students could clarify that an individual is not required to deduct tax from the above payments whereas a company has to deduct WHT (whenever the payment exceeds the specified limits).
- Many students got confused and started explaining the rules related to receipt of such payments and when they can or cannot be treated as full and final settlement of tax liability.
- Q.6 (a) (i) **Retailer:** Most of the students were able to spell out correctly that a Retailer is a person who supplies goods to **General Public** for the purpose of **consumption**.
- (ii) **Distributor:** Only a small number of candidates explained the term with reference to Section 2(7) of the Sales Tax Act, 1990. The others tried to explain it in a generalized manner as if it was a paper of Marketing and wasted a lot of their time.

(iii) **Cottage Industry:** Here again many students tried to answer the question on the basis of their general knowledge. Many of those who did try to explain the meanings as contained in Section 2 (5AB) of the Sales Tax Act 1990, were somewhat confused as regards the following:

- Whether the condition that the turnover should be less than Rs. 5.0 million, applies to taxable supplies only or does it apply to all supplies, whether taxable or otherwise.
- Many students were of the view that two conditions i.e. annual taxable supplies below Rs. 5.0 million and annual utility bills below Rs. 0.6 million have to be met. In fact, compliance with any one of the above conditions is enough, for a manufacturer to be classified as a Cottage Industry.

(b) The students were able to list most of the conditions given in Rule 4 of the Sales Tax Rules 2006 under which it becomes obligatory for a person to get registered under the Sales Tax Act, 1990. However, very few of them could secure full marks by enumerating all the conditions. Some candidates went on to explain the actions that can be taken against persons who fail to register themselves, which was not required.

(c) The performance in this question was good as most of the candidates were able to mention the conditions under which a registered person is de-registered.

Q.7 (a) This part of the question based on Section 23(i) of the Sales Tax Act, 1990 was extremely easy and was done well by almost all the students. Many students were able to at least secure passing marks just by using simple common sense.

(b) (i) Very few of the students were able to quote the provision contained in Section 8B of the Sales Tax Act, 1990 according to which input tax which can be claimed in a tax period shall not exceed 90% of the output tax.

(ii) Very few of the students knew that where claim of input tax is restricted to 90%, it can be claimed subsequently and under the Sales Tax Act, 1990 the persons claiming such a refund have been classified into two categories.

The companies who are subject to audit are required to file a statement duly certified by their auditors, showing value addition less than the prescribed limits alongwith their audited accounts. In case of all other persons the Sales Tax Act, 1990 has authorized FBR to specify suitable conditions and restrictions under which a refund may be allowed.

THE END