

**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN**

**EXAMINERS' COMMENTS**

**SUBJECT**

Advanced Taxation

**SESSION**

Final Examination - Summer 2008

The performance in most cases was far below the level expected in a professional examination. An analysis of this low performance reveals that it was mainly attributed to lack of knowledge, inability to deal with practical situations and the tendency to rush to a conclusion and thereby failing to grasp the exact requirements of the question.

Further, it has also been noticed that the tendency to write the word 'assumed' has increased manifold without any reason as factually very few of the questions required an answer based on any assumption. Some of the students make such assumptions which change the meaning of the question altogether. Such assumptions make the question unduly complicated and result in poor performance. The students are advised to make assumptions only when it is necessary. They would also ensure that such assumptions do not contradict the situation given in the question or its requirements.

**Question-wise comments are given hereunder.**

Q.1 The following errors were generally noted in most of the answer scripts:

- Many students did not know that rent free furnished accommodation is taxed @ 45% of basic salary or the actual rent paid, whichever is less.
- Only about 10% of the students were aware of the fact that the income related to shares issued by the parent company will be classified partly as salary income and partly as capital gain.

For computing income to be classified under the head salary, they should have taken the fair market value of the shares on the date of issue and deducted therefrom, the amount paid when the option was granted and the amount paid when the shares were issued.

The income from Capital Gain should have been computed by deducting the fair market value of the shares as referred to in the above paragraph from the proceeds recovered when the shares were actually sold.

- Most of those who calculated the above incomes correctly under the respective heads, treated the capital gains as exempt from tax in spite of the fact that the parent company was not listed on the stock exchange and could not have been classified as a public company and hence the capital gain on sale of its shares was taxable.

- Many students treated the gain on transfer of assets to the new company exempt, on the basis of the provisions of Section 95 of the Income Tax Ordinance, 1979. They missed an important point that the assets were being transferred to a company which was exempt from tax and hence according to Section 95 (1) (f), such gain was not exempt.
- Many students treated the gain on transfer of assets as taxable but did not justify the treatment.
- Many students were of the view that rental income of Mrs Jehangir was exempt from income tax in accordance with Section 15 (7). They failed to recognize that since she had other source of income i.e. dividend income, she was not entitled to claim the above exemption.

Q.2 Majority of the candidates were unable to understand the question and to solve it in its correct perspective. Many of them compared the aggregate fair market value of all assets with the total consideration received, to work out the gain on disposal on an aggregate basis and treated it either as goodwill or other income or as gain on sale of assets.

The gain/loss in respect of each type of asset should have been computed separately based on the difference between their fair market value and their respective cost, giving due regard to the following:

- Land is not a depreciable asset and is excluded from the definition of capital assets and hence gain on sale of land should not be included in taxable income.
- Consideration against building should have been restricted to its costs.
- Excess of sale proceeds over fair market value should have been treated as goodwill. Surprisingly some students treated it as Royalty.

In part (b) majority of the students could not identify that only inventory and plant and machinery can be classified as “goods” and therefore attracted withholding tax provisions whereas the rest of the items could not be classified as “goods” or under any other head which attracts withholding tax.

Q.3 An average performance was witnessed in this question. Most of the students tried to solve the question without sound planning and therefore ended up making simple mistakes including a lot of duplication and use of incorrect basis of allocation of expenses. Some of the more common mistakes are given below:

- The whole of the sale/profit pertaining to the Locally Purchased Products was either treated under the Final Tax Regime (FTR) or subjected to tax in the normal manner. The correct method was to treat the sale to limited companies under FTR and the remaining sales/profit in the normal manner.
- Most of the candidates allocated the Gross Profit on the basis of sales and did not take into consideration the information provided in para (a) of the question.

- Amortization on intangible assets was also allocated on the basis of sale, although it was clearly mentioned in the question that it related to manufacturing process. Moreover, the fact that amortization for tax purposes shall be determined on the basis of useful life of 10 years, was missed by many candidates.
- Share of income of AOP had been recorded on receipt basis i.e. net of tax. Hence, it should have been grossed up. A large number of students failed to make appropriate adjustment in the tax computation. Consequently, the credit for the tax paid by the AOP was also ignored.
- Surprising, a large number of students were unable to determine that provision for bad debts, for the year, amounted to Rs. 6.0 million and the write-offs amounted to Rs. 8.4 million. Such poor understanding of accounting concepts is not expected at this level of examinations.
- Amount paid to commodity exchange for hedging was incorrectly added back by many students because they incorrectly treated it as part of speculation business whereas in Section 19-2(a) of the Income Tax Ordinance 2001, it has specifically been excluded from the definition of "speculation business". Moreover, those who took it as an allowable expense should have explained the treatment because if taken as an allowable expense, it did not appear in the computation and therefore needed appropriate explanation.

Q.4 This was a very easy question and was attempted well as most students were able to explain that additional tax is levied even if the tax demand is stayed but it is calculated on the basis of amount which is finally determined to be payable, after taking into account the appeal effects.

Q.5 A poor performance was witnessed in this question probably because the candidates were awed by the fact that the question covered the taxability of four different types of entities/assesseees i.e. Unit Trust, Asset Management Company, unit holders of a Unit Trust and Scheduled bank. In fact the question was not that difficult as it tested the very basic and commonly known concepts such as:

- The Unit Trust is exempt from tax if it distributes atleast 90 percent of its accounting income, excluding capital gains.
- An Asset Management Company is taxable in the normal way, as a public listed company.
- Dividend income for a banking company is taxed under the normal law and not under FTR. Further, withholding tax is not applicable on banking companies.
- Capital gain on sale of units by a banking company are taxed at separate rates depending on their period of holding.
- Capital gain on sale of units by a unit holder shall be exempt from tax as the Unit Trust, whether listed or not, is considered to be a public company under the Income Tax Ordinance, 2001.

- Q.6 (a) This was one of the easier questions of the paper. However, only 35% candidates could secure passing marks. The students were generally not aware that initial depreciation is not availed by company operating in a tax holiday as it is against the interest of the company because it is already exempt from tax. This option i.e. the decision not to charge initial depreciation is allowed, however, the company has to charge normal depreciation each year.
- (b) Although many students failed to attempt this part yet a large number knew that when machinery is exported out of country, original cost thereof, is deemed to be its sales price.
- Q.7 This was the best performed question of the paper. However, many students gave the answer in a narrative form and did not show computations for determining the aggregate input tax, output tax payable and the net tax receivable or payable. The other common errors were as follows:
- Some students were of the view that since Sales Tax on items mentioned in the Third Schedule are computed on retail price, the manufacturer shall not be required to collect output tax thereon as it will be collected by the retailers. Some of them were ignorant of the fact that sales tax shall be computed on retail price.
  - Custom Duty on imported hair oil was calculated at 20 percent instead of Rs. 20 per pack. In many cases, custom duty was not added, for determining the value which was subjected to Sales Tax.
  - Most candidate knew that input tax on machinery will be allowed in 12 instalments. However, many of them did not know that the installments will commence after the start of commercial production.
  - Majority of the students ignored an important requirement of the question whereby they were required to give appropriate explanation in case any information given in the question was not utilized (mentioned) in the computation.
- Q.8 This was among the best attempted questions of the paper and about 70% students secured passing marks. The answer was relatively straightforward and students having knowledge of Sales Tax Special Procedure (withholding) Rules, 2007 secured good marks.
- Q.9 Surprisingly, this straightforward question was poorly answered by the students and only 38% secured passing marks. The candidates are advised to study Section 8A of the Sales Tax Act 1990 to understand the points they were expected to cover in their answers.

- Q.10 It was one of the worst attempted question in the paper. The key points which candidates were expected to highlight in the answers are given below:
- (i) The destruction of goods and subsequent compensation received from the insurance company does not constitute a **supply** as defined in the Sales Tax Act 1990, because of the following reasons:
    - it is neither a sale nor a lease.
    - it is not done in the normal course of furtherance of business.
    - it is not done for consideration. Payment by the insurance company is actual compensation for loss and is not payment / consideration for delivery of goods.
  - (ii) Since no supply is involved, no sales tax is payable and therefore no input tax can be claimed in respect of such goods.
- Q.11 It was a straightforward question about determination of value of imported goods. Most of the students produced good answers based on Section 12 of Federal Excise Duty Act 2005.

**(THE END)**