

**KC 3 – Corporate Taxation**

**Suggested Answers and Marking Guide**

# SECTION 1

## Question 01

1.

Relevant Learning Outcome/s:
3.1.1 Outline the provisions of the Inland Revenue Act with regard to taxable sources, returns, assessments, time – bar, finality, appeals and penal provisions.

According to the information given, Mr. Senevirathna has submitted an appeal to the Commissioner General of Inland Revenue (CGIR) and such appeal has been handed over to the CGIR within the stipulated time. Under Section 165(6) of the Inland Revenue Act, receipt of every appeal shall be acknowledged within 30 days of its receipt and where so acknowledged the date of the letter of acknowledgement shall be the date of receipt of the appeal.

In this case CGIR has failed to acknowledge the appeal delivered or to reject the appeal submitted. Therefore, under Section 165(6), when the receipt of any appeal is not so acknowledged, the date on which the appeal was delivered to CGIR will be considered the date of the receipt of the appeal.

Under Section 165(14) of the Inland Revenue Act, every appeal shall be agreed to or determined by CGIR within a period of two years from the date on which such appeal is received by CGIR unless such agreement or determination of such appeal depends on:

- (a) The decision of a competent court on any matter connected to or arising from such appeal referred by CGIR or the appellant; or
- (b) The furnishing of any document or the taking of any action.

In this case neither of the above (a) or (b) is pending and therefore the appeal shall be deemed to have been allowed on the basis that the CGIR has failed to determine the appeal within two years.

Mr. Senevirathna has delivered the appeal on 10th March 2011, therefore according to the Inland Revenue Act, his appeal should have been determined on or before 10th March 2013. Hence, under Section 165(14) the appeal submitted by Mr. Senevirathna is deemed to have been allowed.

Therefore, Mr. Senevirathna shall object to the notice issued for the recovery of tax under Section 179(1) of the Inland Revenue Act. Mr. Senevirathna also has the option of obtaining a Writ of Certiorari to quash the notice issued for recovery of tax.

2.

Relevant Learning Outcome/s:
6.1.1 Explain the significant changes to tax legislation enacted not later than the immediate six preceding months and the impact on corporate and individual taxation.
6.1.2 Evaluate the impact on changes in tax legislations to various business activities.

Mr. Senevirathna has paid income tax in excess of Rs. 250,000 for five consecutive years of assessment upto the Y/A 2012/13. However as per the Finance Act No. 15 of 2011, five year period is ending on 31<sup>st</sup> March 2011. Therefore he is not entitle to a permit under a concessionary duty scheme. Therefore, he is not entitled to a permit to import a motor car on a concessionary duty scheme under the Finance Act.

3.

Relevant Learning Outcome/s:
4.1.1 Assess the output tax, input tax and balance tax payable by a registered person in business which carries out multiple activities.
4.1.2 Advise the statutory obligations with regard to furnishing returns, payment of tax and documentation

Under the Value Added Tax Act and Nation Building Tax Act, liability for VAT and NBT will arise when the taxable supply or the turnover exceeds Rs. 3 Mn for a quarter up to 31/12/2014 and from 01/01/2015 this has increased to Rs.3750,000 per quarter and Rs. 15 Mn per year. Mr. Senevirathna is involved in the business of retail supply of goods purchased locally. Therefore, under the Value Added Tax Act he is not liable on the buying and selling of hardware items as his turnover for a period of three consecutive months does not exceed Rs. 250 Mn.

Although hiring income is within the scope of the VAT Act, the taxable supplies from hiring lorries have not exceeded Rs. 12 Mn therefore Mr. Senevirathna is not liable to register for VAT. However, his liability for NBT will be as follows:

50% of buying and selling turnover	Rs.	8,000,000
100% of hiring income	Rs.	9,000,000
Total	Rs.	17,000,000

As the liable turnover during the period 1/4/2013 to 31/03/2014 is greater than Rs. 12 Mn, liability for NBT has accrued.

4.

Relevant Learning Outcome/s:
3.1.3 Outline the procedures of payment of tax under self-assessment scheme, repayment of tax, recovery of tax in default and penalties for non-compliance.

Mr. Senevirathna who has been treated as a resident for the past two or more consecutive years of assessment has left for Australia in May 2014 and has been absent from Sri Lanka until June 2015.. According to Section 79(3) of the Inland Revenue Act, Mr. Senevirathna is deemed to be non-resident from the Y/A in which he was absent from Sri Lanka for an unbroken period of 365 days. Therefore, Mr. Senevirathna is considered non-resident for income tax purposes for the Y/A 2014/2015.. However, under Section 33 of the Inland Revenue Act, from 1/4/2011 a tax free allowance is available to any individual who is a citizen of Sri Lanka irrespective of whether such individual is resident in Sri Lanka or not. Therefore, Mr. Senevirathna is entitled to a tax free allowance of Rs. 500,000 for the Y/A 2014/15 even though he was non-resident for income tax purposes.

5.

Relevant Learning Outcome/s:
3.1.1 Outline the provisions of the Inland Revenue Act with regard to taxable sources, returns, assessments, time – bar, finality, appeals and penal provisions.

Under Section 112 of the Inland Revenue Act, CGIR may impose a penalty not exceeding Rs. 50,000 for failing to submit his return of income for the Y/A 2014/15 on or before 30th November 2014.

## Question 02

1.

Relevant Learning Outcome/s:
2.1.1 Interpret the meaning of resident status of an individual or company for tax purposes.
2.1.2 Explain statutory provisions with regard to establishment of "profits and income arising in or derived from Sri Lanka".
2.1.3 Assess the "income deemed to be derived from Sri Lanka", form sale or products manufactured, in or outside Sri Lanka, by a non-resident.
2.1.4 Assess the taxable income and the tax payable thoron by a non-resident person.
2.1.5 Explain the liability of an agent of a non-resident person.

AI is a non-resident company for income tax purposes under the provisions of the Inland Revenue Act. Accordingly, every non-resident company is liable for income tax on profits and income arising in or derived from Sri Lanka.

According to Section 62 of the Inland Revenue Act a non-resident company is liable for income tax on:

- 1) Remittances made, at the rate of 10%; and
- 2) Taxable income at the rate specified in the second schedule of the Inland Revenue Act.

In addition to income tax, a non-resident company is also liable for VAT under the VAT Act on taxable supplies made in Sri Lanka, if any, and for NBT on the liable turnover of the company, if any.

According to the information provided, AI is involved in a business of importing and supply of goods and therefore AI is liable for both VAT and NBT.

Further, AI will have to deduct PAYE tax on the remuneration of their employees in Sri Lanka who are liable for PAYE tax and to remit such PAYE tax to CGIR on or before the 15th day succeeding the month of deduction.

2.

Relevant Learning Outcome/s:
1.1.1 Prepare comprehensive income tax computations for any taxable person, whether resident or non-resident.
1.1.2 Assess the income tax liability of “specialized business undertakings “and transactions(including banking and financial institutions, insurance, off-shore transactions, “specified profits” and income and partnerships)
1.1.3 Prepare supplementary statement and alternative computations (including computations of income using “net wealth method” and receipts and payment method, to substantiate the tax liability of a person)

### Computation of income tax liability of AI for the Y/A 2014/15

		<b>(Rs.000)</b>
Net profit after head office expenses		91,000
Add: Disallowable expenses		
Head office expenses	14,000	
Advertising expenses	500	
Entertainment expenses	700	
Depreciation	<u>500</u>	<u>15,700</u>
Less: Allowable expenses		
Depreciation allowance (25% x 5,000)	1,250	
Interest income	9,000	
Dividend income	<u>2,000</u>	<u>12,250</u>
		94,450
Less: Head office expenses		
Actual	14,000	
10% of profit	9,445	
Allowed	<u>9,445</u>	
Statutory income (adjusted profit) from trade		<u>85,005</u>
Add: Interest income		
Net	9,000	
Gross		<u>10,000</u>
Taxable income		95,005

Tax rate	28%	26,601
Remittances made	50,000	
Remittance tax	10%	<u>5,000</u>
Total tax liability		31,601
Less: Tax credit on interest		<u>(1,000)</u>
Balance income tax payable		<u>30,601</u>

3.

Relevant Learning Outcome/s:
2.3.1 Explain the issue of overlapping tax jurisdictions and methods of avoiding double taxation.
2.3.2 Explain the main differences between the OECD model and UN model of tax treaties.
2.3.3 Outline the principal aspects of the operation of a double tax agreement (knowledge of specific double tax agreements is not required)

Relief due to the Company in respect of tax paid in Sri Lanka -

The Company is entitled to claim under the relevant double taxation treaty, a credit in respect of tax paid in Sri Lanka, against the tax payable in the UK on the same income.

Taxes that qualify for relief -

	<b>(Rs. 000)</b>
Income tax (gross amount)	31,601
Withholding tax on dividend	<u>200</u>
Total extent of relief	<u>31,801</u>

The amount of credit cannot exceed the tax payable in UK on the same income.

4.

Relevant Learning Outcome/s:
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2.2.1 Explain the liability of a non-resident company for tax on remittances.
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2.2.2 Compute remittance tax payable by a non –resident company.
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AI has to file a return of remittance on a half-yearly basis with CGIR. This return shall be for the period 1<sup>st</sup> April to 30<sup>th</sup> September and 1<sup>st</sup> October to 31<sup>st</sup> March of a year of assessment. These returns have to be submitted on or before 31<sup>st</sup> October and 30<sup>th</sup> April respectively. If no remittance was made, a nil return has to be submitted.

## SECTION 2

### Question 03

1.

Relevant Learning Outcome/s:
1.1.1 Prepare comprehensive income tax computations for any taxable person, whether resident or non-resident.
1.1.2 Assess the income tax liability of “specialized business undertakings “and transactions(including banking and financial institutions, insurance, off-shore transactions, “specified profits” and income and partnerships)
1.1.3 Prepare supplementary statement and alternative computations (including computations of income using “net wealth method” and receipts and payment method, to substantiate the tax liability of a person)

Migaya Ceramics Lanka PLC (MCLP)

#### Income tax computation for the Y/A 2014/15

		<b>(Rs. 000)</b>
Adjusted profit from trade or business (Working 1)		156,458
Interest on Treasury bonds	5,400	
Add: WHT 10%	600	6,000
Dividends received - not taxable		-
Total statutory income		162,458
Less: Ground rent paid		<u>(750)</u>
Assessable income		161,708
Less: Qualifying payments		
Investment in expansion - Sec. 34 (2)(s)	120,000	
Claimed -25% of the investment		(30,000)
Balance carried forward - Rs. 90,000		
Taxable income		<u>131,708</u>

Computation of income tax liability

		<b>(Rs. 000)</b>
Qualified export profit (Note 1) - 5th Schedule	94,624 x 12%	11,355
Other income - Taxable at normal rate	<u>37,084</u> x 28%	10,383
	131,708	
Total income tax liability on profits and income		21,738
Dividend tax on bonus share issue	193,500 x 10%	<u>19,350</u>
Gross tax liability		<u>41,088</u>

Note 1: Qualifying profit

Adjusted profit from trade or business	131,708
Less: Profit on sale of assets	<u>1,600</u>
	<u>130,108</u>

Q.E.P = (Rs. 2,000,000/Rs. 2,750,000) x 130,108      94,624

Working 1: Adjustment of net profit for tax purposes

		<b>(Rs. 000)</b>
Net profit before tax		101,000
Add: Disallowable expenses		
Impairment of assets	18,000	
Valuation charges	180	
Lease rental	750	
Stock losses- no adjustment is due as this is an expense incurred in the production of income		
Depreciation	138,000	
Entertainment	3,032	
Advertising outside Sri Lanka - this is fully allowable if it has been incurred solely in connection with exports.		
Advertising in Sri Lanka (1/4 of 12,000)	3,000	
Provision for slow moving stocks	4,250	
Provision for retirement benefits	6,250	
Stamp Duty on share issue		
Market Value 15.6@19,350,000		
Stamp Duty on share issue (15.6*19,350,000 )/1000*5		1,509
Trade receipt on disposal		
- Sale proceeds (Note a)	4,600	
- Less: TWDV	3,000	
		1,600
		158,391

Less: Accounting profit on disposal	2,000	
Interest on Treasury bonds	5,400	
Dividend income	8,400	
Research and development		
- triple deduction (1,800 x 2)	3,600	
Gratuity paid (Note b)	3,000	
Depreciation allowance for the year		
Machinery -2012/2013 (40,000 @ 33 1/3%)	13,333	
Machinery -2013/2014 (exports over 60%)		
- 80,000 @ 50%	40,000	
Building 272,000 @ 10%	27,200	<u>102,933</u>
Adjusted profit from trade or business		<u>156,458</u>

Note a: Sale proceeds of assets

Sale proceeds	4,600
Less: BWDV	<u>(2,600)</u>
Profit on disposal	<u>2,000</u>

Note b: Gratuity paid

Provision for Retirement Benefits Account

Opening balance	48,027
Add: Provision for the year	6,250
Less: Payments	<u>(3,000)</u>
Closing balance	<u>51,277</u>

2.

Relevant Learning Outcome/s:
1.2.1 Evaluate effectiveness of tax strategies proposed or implemented in business undertakings, by analyzing financial statements and other relevant information.
1.2.2 Evaluate potential risks in terms of direct and indirect taxes and matters that require corrective measures for statutory compliance.
1.2.3 Compile reports with alternative courses of action available for existing tax issues supported by necessary computations.

The definition of the term dividend has been changed from the Y/A 2012/13. Therefore, from the Y/A 2012/13, the term dividend includes bonus issue of shares and companies issuing bonus shares are required to pay 10% dividend tax on the gross value of the bonus shares issued. Accordingly, on the issue of bonus shares amounting to Rs. 193.5 Mn, MCLP is liable to pay Rs. 19,350,000/- to CGIR as dividend tax.

This dividend tax should be paid within 30 days of the date of its declaration. Every resident company is liable to tax on the deemed distribution of dividends if such company fails to distribute a minimum dividend equivalent to 10% of its distributable profit for the Y/A 2014/2015 on or before 30th September 2015.

Accordingly distributable profit is as follows.

		<b>(Rs. 000)</b>
Accounting profit before tax		101,000
Add: Depreciation on addition to fixed assets		
Building (252,000 @ 10%)		25,200
Machinery (80,000 @ 12%)		9,600
Revaluation loss		<u>18,000</u>
		153,800
Less: Income tax for the year	21,650	
Addition to fixed assets	352,000	<u>373,650</u>
Distributable profit		<u>(219,850)</u>

Since there is no distributable profit for the year, there will not be a statutory requirement to distribute a dividend under the Inland Revenue Act.

Therefore, the decision to distribute bonus shares (considered to be a dividend) has resulted in a cash outflow of Rs. 19,350,000 as dividend tax.

3.

Relevant Learning Outcome/s:

5.4.1 Compile solutions for issues raised by tax authority based on tax payer rights established under statutes and relevant case law (from cases listed in Appendix 4).

5.4.2 Advise for various practical tax issues (including assessments, interpretations, recovery and penal action and litigation).

To : Board of Directors

Subject : Issues raised by the Assessor in the Intimation Letter

From : Financial Controller

With regard to the point raised, the Company cannot agree with the view taken by the assessor.

As per Section 25 of the Inland Revenue Act, all out-goings and expenses incurred in the production of profits and income are allowable expenses.

The stock losses incurred by the Company are incidental to the business of the Company and therefore should be allowed as an out-going.

In the case of Hayley & Co. Ltd vs. The Commissioner of Inland Revenue, it has been held that "the word out-going is wide enough to cover losses, which are involuntary out-goings. The out-goings must be incurred in the production of profits".

Regarding the adequacy of the reason given by the assessor, it has been decided in the case of New Portman Ltd vs. W. Jayawardana and Others, that it is necessary to communicate the substance of the information. Accordingly, the reason provided by the assessor is adequate.

4.

Relevant Learning Outcome/s:

4.3.1 Assess the VAT liability of a registered identified purchaser and registered identified supplier.

4.3.2 Outline the significant features of the Simplified VAT Scheme.

The excess input tax as per the VAT Act is mainly due to the input tax credit from the purchase of tiles from Migaya Porcelain (Pvt) Ltd. MCLP is exporting goods and such exports are more than 50% of the output of the Company. Therefore, MCLP is entitled to register as a RIP under the SVAT scheme.

On the other hand, Migaya Porcelain (Pvt) Ltd would be considered as supplying to the RIP, had MCLP obtained its registration under the SVAT scheme. Therefore, Migaya Porcelain (Pvt) Ltd is entitled to register as a RIS under the SVAT scheme and can issue a "Suspended Vat Invoice" to MCLP which is a RIP.

A RIP (in this case, MCLP) can issue a "Suspended SVAT Credit Voucher" to Migaya Porcelain (Pvt) Ltd who in turn can utilize such credit voucher to set off against their VAT liability.

As a result of this arrangement MCLP would not pay VAT on their purchases from Migaya Porcelain (Pvt) Ltd. MCLP can thereby reduce the burden on their cash flows and might also be able to avoid VAT refunds.