

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KB3 Business Taxation and Law

December 2019

SECTION 1

BUSINESS LAW

Answer 01

Relevant learning outcome/s: 1.1.1
Identify the laws governing companies in Sri Lanka
Study text reference: Pages 4/5

(a)

- The Companies Act No. 07 of 2007 ("the Act") recognises and allows for the incorporation of private limited companies (Section 3(2)).
- Section 4(2) of the Act says that a company (which includes a private limited company) may have a single shareholder where such single shareholder is an individual.
- Section 201 of the Act says that a company (other than a public company) shall have at least one director.
- Further as Mudiyanse is not disqualified from functioning in either capacity, he can get himself appointed as a shareholder as well as a director of any company under the Act.
- Therefore in response to the question, Mudiyanse can incorporate a private limited company where he is the sole shareholder as well as the sole director.

(b) (i)

Relevant learning outcome/s: 4.3.1
Discuss the functions, rights and duties of an Auditor (including provisions contained in the Sri Lanka Accounting and Auditing standards Act No. 15 of 1995)
Study text reference: Pages 80/81

Re-appointing SAMA as the external auditor

Section 156 of the Companies Act No. 07 of 2007 ("the Act") allows for a partnership/firm to be appointed as the company's auditor, provided that all the partners are individually qualified to act as auditors.

As SAMA is the outgoing auditor of the company, it can be reasonably assumed that SAMA is not disqualified under Section 157 of the Act from functioning as the auditor of the company.

Further per the given facts, SAMA has not indicated an unwillingness to continue as the company's auditor for 2019/20.

Therefore MPL can appoint SAMA as its auditor for 2019/20.

The manner of re-appointing

In terms of Section 154 of the Act every company is required to appoint its auditor at its annual general meeting (AGM), and the auditor is to hold office from the conclusion of that meeting until the conclusion of the next AGM.

Therefore MPL can appoint SAMA as its auditor for 2019/20 by its shareholders passing an ordinary resolution to that effect at the AGM for 2019.

(b) (ii)

The Companies Act No. 07 of 2007 specifically gives SAMA (as an auditor) the following rights.

- To access to the accounting books and other records of the company at all times (Section 164 of the Companies Act).
- To require from a director or employee of the company, any information and explanations as they think necessary for the performance of their duties as the auditor (Section 164 of the Companies Act).
- To attend every meeting of the shareholders of the company. The auditor is entitled to receive the notices and communications that a shareholder is entitled to receive relating to a meeting of shareholders (Section 165 of the Companies Act).
- To be heard at a meeting of the shareholders, which the auditor attends, on any part of the business of the meeting which concerns him as auditor (Section 165 of the Companies Act)

(Total: 10 marks)

Answer 02

Relevant learning outcome/s: 2.5.1
Explain pre-incorporation contracts, implied warranties and ratification.
Study text reference: Pages 35/36

(a) A pre-incorporation contract is a contract entered into by a company or by a person on behalf of a company, before such company is formally incorporated.

(b) In terms of Section 23(1), the contract in the given scenario is a pre-incorporation contract.

In terms of Section 24 of the Companies Act No. 07 of 2007, where a person enters into a pre-incorporation contract for and on behalf of a company, that person is deemed to give an implied warranty that:

(i) the company will be incorporated within such period as may be specified in the contract, or if no period is specified, within a reasonable time after the making of the contract. *This has been subsequently satisfied in the given scenario.*

and

- (ii) that the company will ratify the contract within such period as may be specified in the contract or if no period is specified, within a reasonable time after the incorporation of such company.

As the company has not ratified this contract, the onus is on the company to ratify it.

If it fails to do so, then S can apply to court for relief against the company (Section 2).

Therefore in answering the question, whether the company ratifies this contract or not, the company is liable to S on this contract.

(Total: 10 marks)

Answer 03

Relevant learning outcome/s: 3.3.1

Analyse the following principles in relation to capital maintenance in a company (redemption, reduction of capital, financial assistance, share buy-back, minority buy-out)

Study text reference: Pages 56 Sections 93 and 94

(a)

- (i) A minority buy-out right is where the minority shareholders who voted against certain resolutions and instances specified in the Companies Act No. 07 of 2007, are entitled to request the company to purchase their shares.
- (ii) In the given instance, since the minority shareholders have voted against a special resolution regarding a major transaction (which was approved by the decision of the majority of the shareholders), the minority shareholders are entitled to the minority buy-out right.
- (iii) The minority shareholders who wish to exercise this minority buy-out right must give prior written notice to the company of their intention within 10 days of the passing of this special resolution.

(Ref: Sections 93 and 94)

(b)

Relevant learning outcome/s: 3.5.2

The principles relating to "majority rule" and "minority protection" (including "Oppression, Mismanagement and derivative action and Major Transactions) (S.185 of the Companies Act)

Study text reference: Pages 59/60

Section 224 of the Act allows any shareholder (subject to Section 226) to make an application to court for relief for oppression.

According to Section 226, an application under Section 224 may only be made by the shareholders who at any time during the six months prior to the making of the application constituted not less than 5% of the total number of shareholders or held shares which together carried not less than 5% of the voting rights at a general meeting of the company.

In the given scenario, the two shareholders together own 20% (10% + 10%) of the total ordinary shares of the company. This means they have 20% of the voting rights of the company.

This is more than the stipulated minimum of 5% of voting rights.

Further the two shareholders together constitute 20% (i.e. $2/10 \times 100\%$) of the total number of shareholders of the company.

This is more than the stipulated minimum of 5% of the total number of shareholders of the company.

Also, these two shareholders have held these shares for more than the stipulated minimum time period of 6 months.

Therefore these two shareholders are eligible to file an application in court for oppression.

(Total: 10 marks)

Answer 04

Relevant learning outcome/s: 5.1.1
Compare and contrast the different types of meetings in a company, and their purposes and notice periods.
Study text reference: Pages 92/93 Sections 135 (1) (a) and (b)

(a)

Sajith's statement is incomplete and hence only partly correct. It is correct only in relation to a private or unlimited company.

Ajith's statement is also incomplete and hence only partly correct. It is correct only in relation to a company other than a private or unlimited company.

Rajith's statement is accurate, as according to Section 135 of the Act a minimum of fifteen working days' notice in writing is required to call an annual general meeting.

(Ref: Sections 135(1)(a) and (b))

(b)

Relevant learning outcome/s: 6.1.1
Differentiate "compulsory and voluntary winding up" and explain their consequences.
Study text reference: Pages, 112/113 Section 270, Section 267 (1)

(i) Per the given scenario, some of the applicable grounds for BPL to be wound up by court (under Section 270 of the Companies Act No. 07 of 2007) would be as follows.

- BPL should have commenced its business within one (1) year from the year of its incorporation of 2017 (i.e. by 2018). As this has not happened, it is a ground for the company to be wound up by court.
- BPL has no directors, which in turn is a ground for the company to be wound up by court.

(Ref: Section 270)

- (ii) The other modes of winding up available to a company (other than a winding up by court) would be:
- Voluntary winding up. This would include both a shareholders' voluntary winding up and a creditors' voluntary winding up.
 - Winding up subject to the supervision of court.

(Ref: Section 267(1))

(Total: 10 marks)

Answer 05

Relevant learning outcome/s: 7.1/7.1.4

7.1 Security trading process, regulation and insider dealing'

7.1.4 Explain "inside dealing" and relevant information

Study text reference: Pages 134/135/145

(a) (i)

The objectives of regulating the securities market are:

- To help the stock market operate more efficiently (so that it can contribute to the increase in overall wealth of the society)
- To discourage dishonesty and encourage those who adopt or wish to adopt high standards to do so.
- To encourage honest traders to realise that they do not need to adopt dishonest practices to compete with the dishonest, by punishing such practices.
- To promote professional competence and integrity amongst personnel in the securities market.

- (ii) Insider trading refers to the unfair trade of securities to which an "insider" has non-public information that provides an unfair advantage.

It revolves around the ability a trader gains to obtain considerable short-term profit by trading on shares prior to the release of information that only parties with inside information on the operations of the company have.

Relevant learning outcome/s: 8.3

Arbitration

Study text reference: Page 164

- (b) If M intends to enforce the settlement reached between M and V, then M must file **an application containing the arbitral award in High Court.**

The document containing the settlement does not qualify as an 'arbitral award' in terms of the Act, as it was not signed by the arbitrators.

Therefore **there is no arbitral award for the High Court to enforce.**

Hence **M may not succeed** in getting this settlement enforced through the High Court.

(Total: 10 marks)

SECTION 2

BUSINESS TAXATION

Answer 06

Relevant learning outcome/s: 1.2-1.3 Chapter 2
Study text reference: Pages

Software Today (Pvt) Ltd Income tax computation For Y/A 2018/19

	Rs. '000	Rs. '000
BUSINESS INCOME	(+)	(-)
Profit before tax	45,308	
Salaries – additional 35% deduction per Schedule 6 (Rs. 109,260 * 35%)		38,241
Foreign travel – allowed		
Meal expenses – allowed		
Training expenses – since this employment benefit was not considered for PAYE purposes	650	
Balance training expenses – allowed		
R&D – not incurred in improving the business	901	
Considered as investment income		
- Interest income (gross)		427
- Dividend income (net)		540
- Gain on disposal of shares		360
- Profit on sale of computers		743
Rent income (effectively connected to the business)		-
Depreciation	5,340	
Entertainment	1,477	
Donation	50	
Rent – payments on which WHT was not deducted	4,900	
Gratuity provision	4,670	
Gratuity payments made		1,700
Bad debts written off – allowed		
Property, plant and equipment		
Capital allowances for computers (5,600/5)		1,120
Assessable charge: $1,200 - (2,800 - (2,800 * 25\% * 3))$	500	
Finance cost		
Share capital + reserves = 1,875		
Non-manufacturing $1,875 \times 4 = 7,500$		

Long-term loan including lease creditors = 8,000		
Finance cost = 1,631		
Amount allowed = $1,631/8,000 \times 7,500 = 1,529$		
Amount disallowed = $1,631 - 1,529$	102	
Disallowed amount can be carried forward and claimed in the next six years		
	63,898	43,131
Income from business	20,767	
INVESTMENT INCOME		
Interest income		427
Dividend income – final WHT		-
Gain on disposal of listed shares – exempt		-
Gain on disposal of company shares		
Sale proceeds	1,250	
Less: Cost (deemed to be MV as at 30 September 2017)	(1,150)	
		100
Income from investment		527
Assessable income from business		20,767
Assessable income from investment		527
Total assessable income		21,294
Less: Qualifying payments		
Donation made to temple – not allowed		-
Taxable income		21,294
Tax liability		
Gains from realisation of investment assets at 10%	100	10
Balance at 14%	21,194	2,967
<i>Company is predominantly engaged in the business of software development</i>		
Total tax liability		2,977
Less: Tax credits		
Brought forward ESC payments		113
ESC paid during the year		1,550
WHT on interest	427 @ 5%	21.35
WHT on rent	1,500 @ 10%	150
Capital gains tax paid	100 @ 10%	10
Quarterly instalments		250
		2,094
Balance tax payable		883

(Total: 25 marks)

Answer 07

Relevant learning outcome/s: 3.1.1-3.1.4,5.1,5.3,4.2.2,2.2

Study text reference: Pages 22/55-57/68/44-43

HMS Partners**Y/A 2018/19****Computation of income tax payable****Based on the accounts for the financial year ended 31 March 2019****Computation of partnership income/loss**

	Rs.
Net profit per accounts	18,250,000
Add:	
- Salary paid to partners	3,000,000
- Service fee paid to Amal	2,000,000
- Salary paid to Nimal's wife – allowable – no adjustment	-
	23,250,000
Less:	
Interest income – Investment income	(1,200,000)
Business income	22,050,000
Add: Interest income (WHT deducted) <i>Allocated to partners directly</i>	-
Partnership income (allocated to partners)	22,050,000
Withholding tax payable by the partnership at 8% (22,050,000 * 8%)	1,764,000

Share of profit and other income assessable for partners

	Amal	Nimal
Salary	1,440,000	1,560,000
Service fee	2,000,000	
Nimal's wife's salary		720,000
Interest income (is the final WHT payment)	-	-
Balance share of profit	8,525,000	8,525,000
Assessable income	11,965,000	10,805,000

(b) (i)

Taxable supplies	Rs.		Rs.
Sale of ACs	6,500,000	@ 15%	975,000
Sale of generators	3,800,000	@ 15%	570,000
Income from AC installations, computer networking and repair services	1,800,000	@ 15%	270,000
Exempt supplies			
Sale of computers	2,200,000	Exempt	-
Total	14,300,000		1,815,000
Input tax			
Less: Input tax paid on imports		110,000	
Input tax related to computer networking		180,000	
Input tax related to computers – not entitled to claim		-	
Common input tax	240,000		
Less: Input tax relating to exempt supplies <u>2,200,000 * 240,000</u> 14,300,300	(36,923)		
Amount claimable		203,077	
Allowable input tax			<u>(493,077)</u>
			1,321,923
Less: Monthly instalment paid			<u>(1,150,000)</u>
Balance tax payable			<u>171,923</u>

(c)

(i)

Per Section 195 of the Act, an accountant who is a member of CA Sri Lanka or a fellow member of AAT, in relation to a person or any partnership other than a company whose business turnover does not exceed Rs. 100 million for the year.

(ii)

Attesting accuracy and completeness of accounts is required to be done by an approved accountant.

As Kamal is a fellow member of AAT, if the turnover of the partnership is less than Rs. 100 million, he can accept the assignment to attest the accuracy of the accounts. However if the turnover of the partnership is more than Rs. 100 million, he cannot accept the assignment although he is a fellow member of AAT, per the provisions of the Act.

(d)

Where the value of the property is more than Rs. 50,000:

- for every Rs. 100 or part thereof up to Rs. 50,000 → Rs 3.00
- for every Rs. 100 or part thereof after Rs. 50,000 → Rs 2.00

	Rs.
Stamp duty for the first Rs. 50,000 * 3%	1,500
Stamp duty for the next Rs. 1,150,000 * 2%	<u>23,000</u>
Stamp duty payable	<u>24,500</u>

The transfer of property by way of a deed of gift is liable for stamp duty and payable to the relevant provincial council (Western Provincial Council).

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