SUGGESTED SOLUTIONS

KC3 – Corporate Taxation

June 2015

Answer 1
(a)

Relevant Learning Outcome/s:
3.2 Case Law

Suggested Detail Answer:

According to the information Mr. Perera has furnished his return of income for the Y/A 2012/13. Therefore under section 163(3) of the Inland Revenue Act, Assistant Commissioner has to **provide reasons for the rejection of the return**.

In the intimation letter issued under above section, it has been stated that the financial statement submitted **does not reflect the correct profit as the reason for rejection**.

As per the decided case **"New Portman Ltd Vs W. Jayawardane and Others"**, it has been held communicating mere conclusion does not satisfy the requirement under Inland Revenue Act to provide reasons.

In this particular case, Assistant Commissioner has provided his conclusion not valid reasons explaining how he arrived at that decision. **Therefore this cannot satisfy the requirement under section 163(3) of the Inland Revenue Act**. Therefore Mr. Perera **can take up the position that the assessment is invalid due to non-compliance with the provisions under Section 163 of the Inland Revenue Act**.

(6 marks)

(b)

Relevant Learning Outcome/s:
3.1 Statutory Provisions

Suggested Detail Answer:

When a person receives an intimation under sub sections 8 and 9 of the Section 106 of the Inland Revenue Act, if he can provide the necessary particulars so requested such a return becomes a proper return and provisions of the sub section 8 of the section 106 do not apply in respect of such return.

Therefore Mr Perera **has to provide all the particulars of his assets and liabilities** as at the end of the Y/A 2013/14 these particulars **have to be provided within 30 days of receipt of the intimation**. When he provides such particulars within 30 days, **provisions to deem that he "has not furnished the return" do not apply.**

(4 marks)

(c)

Relevant Learning Outcome/s:
4.1 – obligations of a VAT Registered Person

Suggested Detail Answer:

Computation of VAT Liability

Supply liable at Standard Rate				
Supply of metals, rubble and quarry dust	8,000,000			0.5
Transport of goods	2,000,000			0.5
	10,000,000	11%	1,100,000	0.5
Total Output Tax			**1,100,000**	
Less: Input Tax				
Input Tax local	282,000			0.5
Input tax B/F	1,280,000			0.5
Total Input Tax	1,562,000			
Less: Input tax claimable (Limited to 100% of Output Tax)	(1,100,000)		(1,100,000)	0.5
Unabsorbed Excess Input Tax C/F	462,000			0.5
Balance VAT Payable			**NIL**	0.5

(4 marks)

Computation of NBT liability

Supply liable at Standard Rate	8,000,000	2%	160,000
Excepted Services - transport of goods	2,000,000		
Total NBT Liability for the quarter			**160,000**

(2 marks)

(d)

Relevant Learning Outcome/s:
5.3 - Tax Planning

Suggested Detail Answer:

According to the information Mr. Perera is to commence a new business of machine hiring with the help of his son. The income from this new activity is less than Rs. 3.5 million for a quarter. Business he is currently carrying out is already liable to VAT and NBT. Therefore if the new business activity is also commenced under the same proprietorship he will have to pay VAT and NBT on the income generated from the new activity even though such income does not exceed Rs. 3.75 million a quarter. Therefore he can consider a partnership with his son or a limited liability company to commence as a new business activity. By doing this he will be able to avoid the NBT and VAT liability as the forecasted income from new business does not exceed Rs. 3.75 million per quarter.

(5 marks)

(e)

Relevant Learning Outcome/s:
1.2 Impact of taxation on business and finance decision

Suggested Detail Answer:

Form of the business is **changed to a partnership** when there is participation in capital by way of property or money.

Therefore applicable tax is related to partnership. Divisible profit has to be computed and after allowing the tax free allowance (currently 1.0mn), 8% is to be paid on divisible profit and other income.

Administratively a partnership Tax file has to be opened.
Individual partners are entitled to partnership tax credit. Partnership income and partnership tax are to be apportioned to partners (and share of profit is to be considered for personal tax).

If the assets introduced are depreciable assets, depreciation allowances can be claimed.

(4 marks)

(Total 25 marks)

Answer 2

(a)

Relevant Learning Outcome/s:
4.1 - obligations of a VAT Registered Person

Suggested Detail Answer:

TEL (India) is liable to income tax, VAT and NBT in Sri Lanka on account of the following:

- Income from trade or business, on account of providing Technical Consultancy liable to income tax, VAT and NBT

- On account of Interest Income Received- Liable to Income tax only

(4 marks)

(b)

Relevant Learning Outcome/s:
2.3 Double tax treaties

Suggested Detail Answer:

As per the double tax treaty agreement between India and Sri Lanka, when employees of TEL (India) are present in Sri Lanka for more than 90 days, it constitutes a permanent establishment. Therefore TEL (India) is liable to pay income tax on the profits and income arising in Sri Lanka.

(4 marks)

(c)

Relevant Learning Outcome/s:
2.1.4 Assess the taxable income and tax payable thereon by a non-resident person

Suggested Detail Answer:

As per the section 93 of the Inland Revenue Act where interest is payable to a non-resident person on a loan obtained from such person and the interest on such loan is borne directly or indirectly by a person resident in Sri Lanka or by a non-resident person, where the amount of such loan or part thereof has been brought to or used in Sri Lanka such interest is deemed to be profits and income arising in Sri Lanka. However under section 9 of the Inland Revenue Act, interest accruing to any company outside Sri Lanka on a loan granted prior to 1/4/2012 to any undertaking and approved by the Minister as being essential for the economic progress of Sri Lanka is exempt from Income Tax. However from 1/4/2012, interest accruing to any company outside Sri Lanka on a loan granted after 1/4/2012 to any undertaking is exempt from income tax.

Accordingly interest income arising To TEL (USA) on account of loan granted with the approval of the Minister and the interest income arising to TEL (India) after 1/4/2012 are exempt from Income Tax. Therefore profits and income arising from the loan granted by TEL (USA) on 1/4/2010 is the only interest income liable to income tax in Sri Lanka.

(6 marks)

(d)

Relevant Learning Outcome/s:
5.3- Tax Planning

Suggested Detail Answer:

At present interest on loan granted on 1/4/2010 is the only interest income which is liable to income tax. At present criteria used for the exemption of interest is the date loan was granted. Accordingly interest on loan received after 1/4/2012 is exempt. Therefore if the company obtained a new loan to repay the loan received on 1/4/2010 TEL (India) can avoid future income tax liability.

(6 marks)

(e)

Relevant Learning Outcome/s:
2.1.4 - Assess the taxable income and tax payable thereon by non-resident person

Suggested Detail Answer:

Section 97 and section 98 of the Inland Revenue Act provide provisions for the avoidance of double taxation. As per the section 97, double taxation agreement shall, notwithstanding anything in any other written law, have the force of law in Sri Lanka.

As per the section 98, where any person or any partnership proves to the satisfaction of the CGIR that such person or partnership has paid or is liable to pay for any Y/A income tax in Sri Lanka and income tax for the corresponding period in any other country, then such person shall be entitled to relief from income tax payable by him in Sri Lanka.

(5 marks)

(Total 25 marks)

Answer 3

(a)

Relevant Learning Outcome/s:
1.1 – Comprehensive Income Tax computation 6.2 – Financial Reporting and Taxation

Suggested Detail Answer:

Y/A 2014/15

Sources of Income

Trade or business

		Farm Fresh LKR MN	Total (Company) LKR MN
Profit Before Tax		5.00	307.00
Add: Disallowable			
	Amortization of planting cost	2.40	2.40
	Depreciation	12.00	43.00
	Advertising outside Sri Lanka	-	Allowed
	Advertising - local	3.50	9.50
	Foreign Travel Expenses		Allowed
	Impairment of trade & other receivable		1.10
	Entertainment	0.20	1.20
	Penalty - EPF	0.20	1.40
	Stock Written off-Considered as actual written off	Allowed	Allowed
	Provision for retirement benefit	1.20	8.00
	Cash loss	1.31	1.31
		25.81	374.91
Less:	Allowable Deduction		
	Interest Income		14.00
	Planting Cost	7.20	7.20
	Gain on sale of shares		3.00
	Profit on sale of fixed assets		1.20
	Fair Value		1.30
	Actuarial Valuation		2.50
	Depreciation allowance –		
	Machine replaced (note 1)		6.20
	Other machines 20@ $33^1/_3$%		6.67
	Motor Vehicles 15@ 20%	3.00	3.00
	Computers 15@ 25%		3.75
	Research & development – 300% (20,250-6,750)		13.50
	Payment Retiring Benefit (Gratuity)		3.50
		10.20	65.82
	Adjusted profit	15.61	309.09

Total Profit of the company			309.09
Farm fresh profit (10% tax rate)			15.61
Other profit			293.48
Qualified Export Profit (12% Tax Rate)	(2,000 /2600)*293.48		225.76
Local profits related to processed items transfer from farm			67.73
Portion attributable to Farming(Agriculture)……..1			16.93
Portion attributable to Processing(Manufacturing)….3			50.80
Total			**67.73**
Total Business Profit			309.09
Add: Interest Income-FD			6.67
Interest Income- Other-(Exempt)			-
Total Statutory Income			315.76
Assessable Income			315.76
Taxable Income			315.76
Income Tax thereon			
		Rate %	**Tax (LKR mn)**
Qualified Export Profit	225.76	12%	27.09
Profit from Agriculture			
Farm fresh profit 15.61			
Under processing 16.93			
	32.54	10%	3.25
Profit from Business of Manufacturing	50.80	28%	14.22
Interest	6.67	28%	1.87
	315.76	Total income tax payable	46.43

Computation of distributable profit & Minimum Distribution

			LKR MN
Book Profit as per information			307.00
Accounting Adjustment due to IFRS	-Should have been recorded under OCI		
	Actuarial gain	2.50	
	Net gain in fair value of available-for-sale financial assets	1.30	
			(3.80)
Book Profit before tax			303.20
Less:	Income Tax on Profit	46.43	
	Investment in Capital Assets	70.00	
	Tree Planting	7.20	
			(123.63)
			179.57
Add:	Depreciation on additions capital asset	4.00	
	Amortization	2.40	
			6.40
Distributable Profit			185.97
Minimum Distribution to be made -10%			18.60

Note 1	Trade receipt on disposal	
	Sale proceed	2.20
	TWDV	0.80
	Trade receipt on disposal	1.40
	Cost of the replaced asset	20.00
	Less: Trade receipt on disposal	(1.40)
	Adjusted cost	18.60
	Depreciation allowance @ 33 1/3%	6.20

Note 2 Interest from Handsome PLC is exempt

Note 3	Land Clearing Cost	Allowed
	Insurance for agricultural crop	Allowed

(28 marks)

(b)

Relevant Learning Outcome/s:
6.2 – Financial Reporting and taxation

Suggested Detail Answer:

It is clear that preparation of financial statements under the new reporting standards commenced recently whereas income tax regulations are based on Act No.10 of 2006. However we have to address on following factors.

- As per the section 212 of the Inland Revenue Act no 10 of 2006 the Minister (of Finance) may make regulations giving effect to the principles and provisions of the Act.

- Regulations have been issued by way of Extraordinary Gazette No. 1857/8 dated 9th April 2014 by the Minister of Finance under S.212 (c) of the Act No.10 of 2006 .These regulations set out the guidelines on how to make adjustments in the ascertainment of profits or income for tax purposes, and the information required to be provided when adopting Sri Lanka Accounting Standards which consist of Sri Lanka Financial Reporting Standards (SLFRS)/Lanka Accounting Standards (LKAS) in the preparation of financial statements

- Item no.18.4 of that gazette notification dealt with the financial instruments classified under "Available for sales (AFS)". As per there guidelines valuation gains are not taxable. (When such assets are derecognized and/or disposed of only, the cumulative gains or losses transferred to the statement of comprehensive income will be taxed or allowed as deduction.)

Therefore gains arising on valuations under new financial reporting standards are not subject to income tax as necessary regulations are in place explaining how to deal with such gains.

(7 marks)

(c)

Relevant Learning Outcome/s:
5.4 – Providing tax advice

Suggested Detail Answer:

According to the section 163(3) Assistant Commissioner has to give reasons only in the case where the return submitted is not accepted and an estimation of assessable income has been made. In this particular case Assistant Commissioner neither rejects the return nor is an estimation of assessable income made.
Assessment has been issued due to an error in the application of the tax rate and therefore it is not required to provide reasons Hence company cannot take up the position that no reason has been given. The dispute over the tax rate has to be resolved with the authorities by providing the relevant details.
If company is not satisfied with the conclusion of the Assistant Commissioner/ Assessor about the tax rate applicable, the company may make a writ application to court of appeal to rectify the issue.

(5 marks)

(d)

Relevant Learning Outcome/s:
3.1 – Statutory Provisions

Suggested Detail Answer:

The change of the accounting period is a matter governed by Section 28 of the Act. Since accounts are normally kept to 31st March the practice of LFPL keeping the accounts to 31st December must have been done with the prior permission (direction) of the Commissioner General of Inland Revenue. When there is a deviation from the accounting period especially permitted by the Commissioner General, Section 28 (2) requires that the profits for the year of assessment in which the change occurs and the two subsequent years should be computed in a manner which the Commissioner General shall be able to consider just and equitable. In other words, the company is free to commence keeping accounts to 31st March. It is for the company to decide when to effect the deviation. It is recommended that before changing back to 31st March, permission from Commissioner General to be obtained since there is no other way to ascertain whether method of accounting for that year and subsequent periods is just and equitable to the Commissioner General.

(5 marks)

(e)

Relevant Learning Outcome/s:
4.3 – Simplified VAT Scheme

Suggested Detail Answer:
As per the simplified VAT system a person who is supplying services to a registered identified purchaser (RIP) should be registered as a registered identified supplier (RIS). Therefore HBCA has to obtain SVAT registration number as RIS furnishing the necessary documents. Then they have to issue "SVAT" invoices with required details to purchaser. Within 10 days of end of the each month HBCA should submit forms "SVAT 4" and "SVAT 5" to LFPL and before 15 days from end of the month LFPL should issue the credit vouchers for VAT element. It is recommended that the guidelines issued for other relevant documentation and communications with the Department of Inland Revenue be followed.
(5 marks)

(Total 50 marks)

Notice of Disclaimer

The answers given are entirely by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and you accept the answers on an "as is" basis.

They are not intended as “Model answers’, but rather as suggested solutions.

The answers have two fundamental purposes, namely:

1. to provide a detailed example of a suggested solution to an examination question; and

2. to assist students with their research into the subject and to further their understanding and appreciation of the subject.

The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) makes no warranties with respect to the suggested solutions and as such there should be no reason for you to bring any grievance against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). However, if you do bring any action, claim, suit, threat or demand against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), and you do not substantially prevail, you shall pay the Institute of Chartered Accountants of Sri Lanka's (CA Sri Lanka’s) entire legal fees and costs attached to such action. In the same token, if the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is forced to take legal action to enforce this right or any of its rights described herein or under the laws of Sri Lanka, you will pay the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) legal fees and costs.