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SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE
PROGRAMME

INTAKE II/III/IV – GROUP B
END SEMESTER EXAMINATION – JULY 2016

AFM 20830 Taxation

Date : 24th July 2016
Time : 9.00 a.m. – 12.00 p.m.
Duration : Three (03) hours

Instructions to Candidates:

- The paper consists of three parts (I, II and III)
- Part I – Answer **ALL** questions in the separate sheet given
- Part II – Answer **ALL** questions
- Part III – Answer **ANY TWO (02)** questions
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly.

PART I

Answer **ALL** questions

Question No. 01

1. Mr Piyal submitted his income tax return for the year of assessment 2014/2015 on 4th December 2015. What is the date ending the *time bar* for Mr Piyal for the above return?
 - a. On or before 30th November 2018
 - b. On or before 30th November 2015
 - c. On or before 30th May 2017
2. A donation by an individual to an approved charity which provides institutional care for sick and needy people can be deducted;
 - a. Up to 1/5th the assessable income
 - b. Up to 1/3rd the assessable income
 - c. Lower of 1/3rd of the assessable income or Rs 75,000 whichever is lower
3. An individual has received a total remuneration of Rs 1,200,000 for the year of assessment 2015/2016. Determine the amount of *exempted profit* from employment.
 - a. Rs 750,000
 - b. Rs 250,000
 - c. Rs 450,000
4. A Company is **required** to pay dividend tax at 10% in which of the following scenarios.
 - a. Dividends distributed out of its own profits
 - b. Dividends distributed out of dividends received where 10% dividend has already been deducted
 - c. Divided distributed to a mutual fund or to a unit trust

5. The net interest income received by Mr Appuhami is Rs 90,000. Which of the following statements is *true*?
- a. Gross interest income Rs 100,000 should form a part of assessable income of Mr Appuhami and Rs 10,000 can be deducted as a tax credit
 - b. This interest income shall not form a part of Mr Appuhami's assessable income as WHT deducted is the final tax
 - c. Net interest income of Rs 90,000 should form a part of assessable income of Mr Appuhami and there is no tax credit
6. Sapumal and Samanmali are legally divorced. Their five year old son Saman lives with Samanmali. Saman's income should be added to that of;
- a. Sapumal
 - b. Samanmali
 - c. Both Sapumal and Samanmali equally
7. Determine the vehicle for which depreciation allowance *cannot* be claimed.
- a. Lorry purchased for goods transport
 - b. Car purchased for Director's official travelling
 - c. Motor cycle purchased for the use by a non-executive officer
8. Turnover of A Ltd is Rs. 85,000,000. The company pays a management fee of Rs. 1,200,000 to its parent. Amount approved by CGIR is Rs.900,000. Determine the allowable management fees for tax purposes.
- a. Rs 850,000
 - b. Rs 900,000
 - c. Rs 1,200,000

9. Ms. Anoji, a CEO of a public listed company, bought 5 blocks of land in Colombo area. However, as Anoji's family decided to migrate permanently, she appointed an agent, a popular land sales company, to sell those lands on her behalf. After few months, she was able to sell all 5 blocks of land making a considerable profit. Select the *false* statement.
- a. The land sales company should pay income taxes on any commission income it earned on above land sale
 - b. Ms Anoji has been led by the profit motive purpose, so that she is liable to pay income taxes on the profit she made through land sale
 - c. This transaction is not an adventure in the nature of trade, so that Ms Anoji is not liable to pay income tax on the profit generated through land sale
10. XYZ PLC is a gas importer who does gas transportation by its own three special ships. The CFO argues that the freight cost that would have incurred if they have hired a ship should be recognized as an expense in the income statement of the company. Determine the tax implication on the CFOs argument.
- a. Such cost is notional and shall not be an allowable expense for tax purposes
 - b. Such cost is notional and XYZ can deduct as an valid expense for tax purposes
 - c. Company should take the fair value of the freight cost to make it as an allowable expense.

(Total 20 Marks)

PART II

Answer **ALL Four (04)** questions

Question No. 02

- i. Mr. Mahinda is employed as the Finance Director of a company. The **monthly** salary details of Mr. Mahinda is as follows for the year of assessment 2015/2016.

Pay Sheet

Basic salary	250,000
Incentives	75,000
Gross salary	325,000

In addition, following information is related to his employment.

- He was provided with a BMW car (engine capacity 2000 cc) with a driver and the fuel cost was borne by the company.
- Mr. Mahinda is entitled for a payment of $\frac{1}{2}\%$ of the profits of the company, as part of his employment contract. As a result, he received Rs 1.5 Mn in May 2016 after the accounts of the company for the year ended 31st March 2016 were completed and audited.
- The company has paid a rent of Rs 240,000/= for his residence for the year, as agreed in the service contract.
- The residence telephone bill of Rs 60,000/= was paid by the company.

Required:

Calculate the **employment income** of Mr Mahinda which will form a part of his assessable income for the year of assessment 2015/2016.

(09 Marks)

ii. Ms. Sashikala, was a CEO of a reputed quoted company who has resigned on 31st March 2016 after completion of successful 35 years of service at the same company. At the retirement she received the following retirement benefits.

- She was paid a retirement gratuity of Rs. 40 million
- She was entitled for an EPF payment of Rs. 18 million and ETF payment of Rs. 3 million
- At the time of retirement she was paid a monthly salary of Rs 1,000,000 and for last two years her salary was increased by Rs 65,000 (2015) and Rs 50,000 (2014) respectively.

Required:

Separate the retirement benefits received by Ms Sashikala as **exempted** from income tax, benefits liable under **concessionary rates** and benefits liable under **normal rates**.

(06 Marks)

(Total 15 Marks)

Question No. 03

i. Mr Sisira, a businessman, has three houses as follows.

Location	Way of acquisition	Usage	Rating Assessment
Colombo 05	Purchased	Sisira & family live	Rs 300,000
Kandy	Inherited	Let on rent	Rs 250,000
Kaduwela	Built by Sisira	Sisira's parents live	Rs 200,000

- The house in Kandy has been let on rent to a school friend of Sisira and he receives a nominal rent of Rs 10,000 per month. The rates for all three houses are paid by Mr Sisira at a rate of 20% on the Rating Assessment.

Required:

a. What is the net annual value (NAV) that should be taken as a part of the assessable income of Mr Sisira?

(04 Marks)

b. Calculate the rent income of Mr Sisira for income tax purposes.

(04 Marks)

c. Does any house create an occupier's income? If so what is the amount of occupier's income?

(02 Marks)

ii. Amal has a furnished house in Colombo which is rented at Rs.12,000 per month. Rating assessment of the house is Rs. 80,000 and rates are payable at 20%. Within the year following expenses have been incurred by Amal.

- Brokerage	Rs. 5,000
- Furniture upkeep expenses	Rs 9,000
- Purchase of new furniture	Rs. 25,000
- Depreciation	Rs. 3,500

Required:

Compute

a. the rent income; and

b. the profit from furnishing

(05 Marks)

(Total 15 Marks)

Question No. 04

- i. The management of ABC PLC proposed to make a dividend distribution on the after tax profit of Rs 9.75 Mn earned during the year 2014/2015. As a result on 01st October 2015, the company decided to pay Rs.390,000 as dividends to its shareholders of which Rs 50,000 was paid out of the dividend income received from ABC's subsidiaries. 30% shares of ABC PLC are held by a unit trust and the rest is owned by individual investors.

During the year 2015/2016 company added two new showrooms incurring Rs 5 Mn and they have charged Rs 250,000 as the depreciation for the current year for those additions. The income tax liability for 2014/2015 was estimated at Rs.1.2 Mn.

- a. **List** down the taxes liable with regard to the distribution of profits to its shareholders.
(Type of the tax and the rate applicable)

(04 Marks)

- b. **Calculate** the tax liabilities specified in (a) above indicating the basis of tax liability and exemptions applied, if any.

(08 Marks)

- ii. **List** three exemptions available for an individual person in terms of interest income.

(03 Marks)

(Total 15 Marks)

Question No. 05

Ms. Asha is a graduate from a reputed national university. She is a talented entrepreneur and has started manufacturing of garment products to the local market few years ago as a sole proprietor.

Her accountant has prepared financial statements for her business for the year 2015/16. Some extracts of the financial statements are as follows.

Profit & Loss Statement for the year ending 31.03.2016

	Notes	Rs.'000	Rs.'000
Revenue			34,128
Cost of Sales			(24,725)
Gross Profit			9,403
Other Income	01		1,130
			10,533
<u>Less: Expenses</u>			
Salaries & wages	02	2,263	
Personal income tax of Asha		47	
Children's school fees		75	
Overdraft interest		134	
Contribution to EPF and ETF		185	
Repair expenses	03	1,205	
Traveling & transport expenses	04	967	
Entertainment expenses		355	
Commercial advertising expenses		640	
Payment for ISO certificates		85	
Payment for trade associations		24	
Penalty payment for delay in submitting VAT return		23	
Accounting & taxation fees for the business		235	
Donations/payments		310	
Depreciation of property, plant & equipment	05	1,075	(7,623)
Net Profit			2,910

Note 01

Other income consists of following.

	Rs. '000
Dividends received from Herath PLC (Net)	1,000
Motor lorry disposal gain	<u>130</u>
	<u>1,130</u>

Note 02

Salaries and wages includes a sum of Rs.500,000 paid to Asha's husband as consultancy fees.

Note 03

Repair expenses consist of Rs. 800,000 incurred to repair the manufacturing plant on 1st April 2015. Due to this repair the plant's manufacturing capacity has been increased significantly.

Note 04

The summary of the traveling & transport expenses is as follows.

	Rs.'000
Business purpose local transport	200
Family tour to China	500
Meetings with potential customers in USA	<u>267</u>
	<u>967</u>

Note 05

Business has following property, plant and equipment as at 31st March 2016. (Rs.'000)

Description	As at 1/4/2015	Additions	Disposals	As at 31/3/2016
Land	3,000	-	-	3,000
Manufacturing Plant	2,500	-	-	2,500
Motor Vehicles	2,000	1,500	1,000	2,500

Manufacturing plant and motor vehicles have been purchased on 01.04.2014. on 31st March 2016, the business disposed a lorry and purchased another similar lorry on 1/3/2016. The business has depreciated the motor vehicles on 25% per annum on straight line basis.

Required:

Calculate the profit from business (adjusted business profit) of Ms. Asha for the year of assessment 2015/16.

(Total 15 Marks)

PART III

Answer any Two (02) questions

Question No. 06

“The tax system is not delivering the potential revenue in Sri Lanka. Sri Lanka’s per capita income has increased from US\$ 720 in 1995 to US\$ 3,625 in 2014 but our tax revenue has declined from 20.4 % GDP to 12.8 % GDP during this period.”

Briefly describe FOUR **fundamental problems** of the present tax system in Sri Lanka that results in a lower tax revenue compared to other peer countries.

(Total 10 Marks)

Question No. 07

“Withholding tax is a tax deducted at source. A withholding tax, also called a retention tax, is a government requirement for the payer of an item of income to withhold or deduct tax from the payment, and pay that tax to the government.”

List THREE income sources from which the WHT is deducted and **describe** the purpose of introducing Withholding Taxes (WHT).

(Total 10 Marks)

Question No. 08

Since taxes have economic effects on the entire community, the tax system should be formulated to cause as little disturbance as possible to economic activity and productive efficiency, so that the system of income tax should be based on certain widely accepted principles. However, in Sri Lankan context, the effective application of these set out principles is questionable.

Briefly explain the principle “The stability of taxation system” and **evaluate** to what extent this principle is applied in Sri Lankan taxation system.

(Total 10 Marks)