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THE INSTITUTE OF  
**CHARTERED** ACCOUNTANTS  
OF SRI LANKA

# **SUGGESTED SOLUTIONS**

**KE3 (A) – Fundamentals of Taxation**

**September 2017**

## SECTION 01

### Answer 01

#### 1(a)

1.1

<b>Learning Outcome/s: 1.2.2</b>
Identify the major taxes in Sri Lanka.
Study text reference: Page 9
<b>Correct answer: B</b>

1.2

<b>Learning Outcome/s: 2.2.4</b>
Identify the "miscellaneous exemptions" under the Inland Revenue Act (Sec. 13) applicable to an individual and capital gains.
Study text reference: Page 55
<b>Correct answer: A</b>

1.3

<b>Learning Outcome/s: 3.1.5</b>
Explain the tax liability of a company on distributions.
Study text reference: Page 95
<b>Correct answer: B</b>

1.4

<b>Learning Outcome/s: 4.2.2</b>
List the characteristics of a valid appeal and the steps of an "appeal settlement".
Study text reference: Page 109
<b>Correct answer: C</b>

1.5

<b>Learning Outcome/s: 5.2.1</b>
Explain the applicability of NBT to small and medium-sized businesses, and the registration threshold.
Study text reference: Page 136
<b>Correct answer: D</b>

**(2 x 5 = Total: 10 marks)**

## 1(b)

1.6

<b>Learning Outcome/s: 1.1.1</b>
State the economic and social functions of taxation.
Study text reference: Page 5
<p><b>Social functions</b></p> <ul style="list-style-type: none"><li>• Discourage activities that are undesirable by society.</li><li>• Encourage activities that are desirable by society.</li><li>• Reduce the income disparity between the rich and poor.</li></ul> <p><b>Economic functions</b></p> <ul style="list-style-type: none"><li>• Set the foreign and local investments direction.</li><li>• Protect local industries from foreign competition.</li></ul>

1.7

<b>Learning Outcome/s: 3.1.3</b>	
Compute total statutory income, assessable income and taxable income of a company by making relevant statutory deductions.	
Statutory income from trade	= 414,650,000
Dividend income (exempt)	= -
Total statutory income	= <u>414,650,000</u>
Less: Deduction under Sec. 32	= <u>-</u>
Assessable income	414,650,000
<b>Less:</b>	
Qualifying payment community project (Rs. 11 million)	
Limited to	= <u>(10,000,000)</u>
Taxable income	= <u>404,650,000</u>

1.8

**Learning Outcome/s: 4.4.3**

State briefly how a valid claim can be made for a tax refund of overpaid tax.

Study text reference: Page 113

A person who has paid excess tax, either through payment or by deduction, should make a claim in **writing** within **three years of the end of the year of assessment** with sufficient **proof of overpayment**, in order to satisfy the Commissioner General that he is entitled to a refund .

He should then submit an amended return with the refund claim.

1.9

**Learning Outcome/s: 4.5.2**

Explain the PAYE scheme and obligations of an employer under this scheme.

Study text reference: Page 115

- PAYE should be deducted from remuneration of employees according to the tables provided.
- Employer should notify the CGIR within seven days when an employee becomes liable for PAYE.
- PAYE should be deducted from remuneration allowed to directors, who are not considered as employees and individuals in respect of whom such employment is their second employment, as follows:
  - If the value of benefits does not exceed Rs. 25,000 per month: 10%
  - If the value of benefits exceeds Rs. 25,000 per month: 16%
- Tax deducted every month should be remitted by the 15<sup>th</sup> of the following month.
- The employer must issue a certificate to the employee (T10), giving full particulars of the salary and tax deducted before 30<sup>th</sup> April following the end of the year (Certificate of Tax Deduction).
- The Certificate of Tax Deduction should be given within 30 days to any employee who ceases employment.
- The employer has to send an Annual Declaration before 30 April following the end of the year of assessment, giving full details of all the employees and their tax deductions.

1.10

**Learning Outcome/s: 5.1.2**

Compute tax payable for a given straightforward, non-complex scenario.

Study text reference: Page 127

Output tax	6,765,000 @ 15%	1,014,750
Less:		
Input tax	517,000	
Less: Disallowed VAT paid on motor cars	(45,000)	
	472,000	
Input tax brought forward	<u>16,500</u>	(488,500)
<b>VAT payable</b>		<b><u>526,250</u></b>

**(2 x 5 = Total: 10 marks)**

## SECTION 2

### Answer 02

#### Relevant Learning Outcome/s: 3.1

Basic understanding of income tax liability of a resident company (non-complex straightforward scenario)

### Computation of gross income tax liability and balance tax payable by Asian Chemicals (Pvt) Ltd for the year of assessment 2016/17

		Rs.	Rs.
		+	-
Net profit per accounts		53,542,000	
Less: Interest income (net)			540,000
<b>Add/deduct:</b>			
Entertainment allowance paid to managing director		240,000	
Advertising expenses	659,000		
Less: Staff recruitment (100% allowed)	<u>(75,000)</u>		
<b>Limited to 25% of advertising</b>	<b>584,000</b>	146,000	
Donation		100,000	
Gross rent income (no adjustment as it is part of business income)			-
Repairs limited to 25% of gross rent or actual, whichever is lower			
Repairs expenses	300,000		
Limited to 25% (1,000,000 @ 25%)	<u>(250,000)</u>		
Disallowed	<u>50,000</u>	<u>50,000</u>	<u>540,000</u>
		<u>54,078,000</u>	<u>540,000</u>
<b>Adjusted profit from trade</b>		<b>53,538,000</b>	
Add: Other sources of income			
<b>Interest income</b>			
Gross interest (540,000 x (100/90))		600,000	
<b>Total statutory income</b>		<b>54,138,000</b>	
Less: Statutory deductions			
Losses brought forward (Rs. 1,250,000)		(1,250,000)	
Limited to 35% of total statutory income (18,948,300)			
Therefore can claim the full amount			
<b>Assessable income</b>		<b>52,888,000</b>	
<b>Less: Qualifying payments</b>			
Donation to the government (100% claimable)		(100,000)	
<b>Taxable income</b>		<b>52,788,000</b>	
<b>Tax liability</b> (52,788,000 × 28%)		14,780,640	

<b>Less: tax credits</b>	-		
Self assessment payment		(12,000,000)	
WHT on interest		<u>(60,000)</u>	
<b>Balance tax payable</b>		<b>2,720,640</b>	

(Total: 10 marks)

### SECTION 3

#### Answer 03

<b>Relevant Learning Outcome/s: 2.2, 2.3 and 2.4</b>	
2.2	Statutory income from sources of profits and income listed in the Inland Revenue Act.
2.3	Total statutory income, assessable income and taxable income.
2.4	Gross income tax and balance tax payable.

<b>Computation of income tax payable by Sujeeva for the year of assessment 2016/17</b>		
	<b>Rs.</b>	<b>Liabe Rs.</b>
<b>Employment income</b>		
Salary (260,000 x 12)		3,120,000
Vehicle allowance (60,000 x 12 = 720,000)		
Vehicle allowance up to 50,000 p.m. (exempt 600,000)		120,000
Rent-free residence		
Rental value = RA + rates = 200,000 + 40,000 = 240,000		
Statutory limit = 180,000		180,000
Life insurance premium (3,000 x 12)		36,000
Employer's contribution to an approved fund (allowed)		-
<b>Statutory income from employment</b>		<b>3,456,000</b>
<b>Rent income</b>		
Gross rent received (20,000 x 12)	240,000	
Less: Rates (100,000 x 10%)	<u>10,000</u>	
	230,000	
Less: 25% for repairs	<u>57,500</u>	
Net rent	<u>172,500</u>	
NAV = RA - 25% of RA = 100,000 - 25,000 = 75,000		
Net rent is more that NAV, therefore net rent is taxable		<b>172,500</b>
<b>Interest income</b>		
From a fixed deposit account Rs. 292,500 was received during the year. As withholding tax has been deducted it does not form part of the assessable income.		-
US\$ 400 from NRFC account (exempt from tax)		-
<b>Net dividend</b>		

Net dividend of Rs. 102,000 received from a BOI company does not form part of the assessable income since WHT has been deducted.			
<b>Business income</b>			
<b>Net profits per accounts</b>		2,633,000	
<b>Add/(less):</b>			
Loss on disposal of computer		35,000	
Fines and penalties		58,000	
Book depreciation – computer		50,000	
Taxable profit/(loss) on computer			
Sales proceeds		25,000	
Less: Cost	120,000		
Tax dep <sup>n</sup>	(30,000) (90,000)		
Tax loss	(65,000)	(65,000)	
Capital allowance on replaced computer (100,000 x 25%)		(25,000)	
Repairs (60,000/3,000 x 2,500) (Personal) (Disallowed)		50,000	
Repairs (7,500/3,000 x 2,500) (Personal) (Disallowed)		6,250	
Rent (120,000/3,000 * 2,500)		100,000	
<b>Adjusted business profit</b>		2,842,250	2,842,250
<b>Total statutory income</b>			<b>6,470,750</b>
<b>Less: Deductions under Section 32</b>			
Interest paid on loan taken for car (Not allowed)			-
<b>Assessable income</b>			<b>6,470,750</b>
Less: Qualifying payments			
Qualifying payment on employment income			(250,000)
Capital payment (Not allowed)			
Donation for sick and needy		45,000	
Life policy premium		36,000	
		81,000	
Limited to 1/3 of AI or 75,000, whichever is less			(75,000)
Personal allowance			(500,000)
Nothing can be deducted from employment income. However, he has enough other sources of income, therefore the life policy premium can be deducted.			
<b>Taxable income</b>			<b>5,645,750</b>
First 500,000 @ 4% = 20,000		} 120,000	
Next 500,000 @ 8% = 40,000			
Next 500,000 @ 12% = 60,000			
<b>Business income (Section 59B)</b>			
<b>(2,842,250 - 75,000) = 2,767,250</b>			
2,767,250 @ 12% = 332,070			
Balance 1,378,500 @ 16% = 220,560			
<b>Gross income tax payable</b>		<b>672,630</b>	<b>672,630</b>
<b>Less: Tax credits</b>			
Self-assessment		300,000	
PAYE		312,960	(612,960)
<b>Balance tax payable/(refund due)</b>			<b>59,670</b>

**(Total: 20 marks)**



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