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

YEAR IV SEMESTER II – INTAKE I
END SEMESTER EXAMINATION – JULY 2017

AFM 41730 Advanced Taxation and Strategic Tax Planning

Date : 17th July 2017
Time : 5.30 p.m. - 8.30 p.m.
Duration : Three (03) hours

Instructions to Candidates:

- Answer **ALL** questions.
- The paper consists of three parts (A, B and C)
- 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 A

Answer **ALL** Questions

Question No. 01

1. Which one of the following **is not relevant** for selecting the most appropriate transfer pricing method.
 - a. Nature and class of transaction
 - b. Functions, Assets and Risks undertaken of assessee and other party
 - c. Education qualification of the board of directors
 - d. Extent to which reliable and accurate adjustments can be made to account for differences, if any

2. Which of the following statements **is not true** in relation to the appeal procedure under the Inland Revenue Act No. 10 of 2006?
 - a. Appeal should be addressed to the Commissioner General.
 - b. Valid appeal should be in writing.
 - c. A valid appeal must be made within thirty days (30) from the date of notice of the assessment.
 - d. The determination by the Commissioner General must be made within three years (3) from the date of receiving a valid appeal.

3. The following statements are given for your review:
 - A. Tax planning also ensures better compliance with the tax laws and thereby avoids any penal action being taken against the organization.
 - B. Tax Planning also helps to identify tax risks and encourages proactive measures for legally reducing such risks.

According to the partial application and outcome of the ethical tax planning, which of the above statements is/are correct?

- a. Both (A) and (B) are correct.
- b. Both (A) and (B) are incorrect.
- c. Only (A) is correct.
- d. Only (B) is correct.

4. Non-resident person is required to pay tax based on the profit or income arrived or derived from Sri Lanka.

Which of the following statement correctly shows the position related to the taxation of non-resident person?

- a. An individual who is physically present in Sri Lanka for 270 days or more in a year of assessment will become a resident person for tax purpose.
 - b. Any non- resident persons return of income should be filed on or before 31 December following the end of that year of assessment.
 - c. Regarding the service rendering in Sri Lanka, where contract was signed is a main condition to determine the chargeability of non-resident person.
 - d. Where business transaction can be performed directly or through an agent in Sri Lanka by non-resident person.
5. State whether each of the following statements are **TRUE** or **FALSE**.

Write the selected answer (True / False) in your answer booklet with the number assigned to the question.

a. Though there was a willful evasion identified, Department of Inland Revenue cannot issue an assessment after expiration of the time bar period	T/ F
b. If the lottery prize received is less than Rs.500,000/-, income tax is not required to be paid by a person on such income.	T/ F
c. From rent income, rates and repair expenditure are deductible without any restriction.	T/ F
d. The penalty that could be imposed for making an incorrect return is a sum not exceeding Rs. 30,000/-.	T/ F

(Total 10 Marks)

PART B

Answer **ALL** Questions

Question No. 02

You are required to provide short answers to all questions with attention given to action verbs.

- a. Mr. Kumaranayake is a doctor and filed his return of income for the year of assessment 2014/2015 on 15th November 2015. Assistant Commissioner issued an assessment on this return on 25th May 2017. But he did not agree with this assessment.

He expects an advice from you on this matter.

- b. “**Double tax treaty**” is a most appropriate tool to mitigate the double taxation effect.

Explain the steps to be wisely applied in the domestic law and double tax treaty for taxation of the non-resident person.

- c. “Tax planning” is the process of preparation for the payment of taxes completely, correctly and economically.

List down the four options which can be implemented for better tax planning by tax payer.

- d. “**Ram Isewra Vs CIR**” court case is a land mark tax case for deciding the adventure nature of business.

Briefly explain What are the main facts which were considered by the court to decide the Ram Isewra Vs CIR case?

- e. **Briefly explain** what are the things that need to be considered to select the “**comparable**” for determining the “**arm length price**”.

(Total 10 Marks)

PART C

Answer **ALL** Questions

Question No. 03

Hill Towers (Pvt) Ltd is a resident company incorporated in July 2014. The company is in the business of importing & selling floor tiles and other related accessories.

The net profit before income tax of Hill Towers (Pvt) Ltd for the year ended 31st March 2017 after charging all expenses and crediting all income was Rs.6,550,000/-. Total turnover of the company for the same year was Rs.660,500,000/-.

Notes to the accounts:

Note 1 Property, Plant and Equipment

1. Cost

Description	Balance as at 01.04.2016	Addition	Disposal	Balance as at 31.03.2017
Land	11,000,000	2,000,000		13,000,000
Buildings	5,000,000	3,000,000		8,000,000
Computer Hardware	4,750,000	1,500,000	2,200,000	4,050,000
Computer Software	3,550,000	1,250,000		4,800,000
Machinery and Equipment	8,100,000	1,500,000		9,600,000
Motor Vehicles	6,100,000		3,100,000	3,000,000
Furniture	2,500,000			2,500,000
Photo Copy Machine	660,000		240,000	420,000
Total	41,660,000	9,250,000	5,540,000	45,370,000

2. Depreciation

Description	Balance as at 01.04.2016	Addition	Disposal	Balance as at 31.03.2017
Buildings	4,000,000	1,680,000		5,680,000
Computer Hardware	2,550,000	980,000	1,350,000	2,180,000
Computer Software	2,050,000	560,000		2,610,000
Machinery and Equipment	3,020,000	2,150,000		5,170,000
Motor Vehicles	4,325,000	845,000	2,250,000	2,920,000
Furniture	1,300,000	550,000		1,850,000
Photo Copy Machine	550,000	250,000	150,000	650,000
Total	17,795,000	7,015,000	3,750,000	21,060,000

3. A land was acquired to construct a building during the year and construction of the building has been completed. The company started using the building in the business during the current financial year.
4. New Computer Hardware is a replacement for a old Computer Hardware purchased on 1st November 2014 which was destroyed by fire during this year of assessment. Insurance claim has not been received due to disagreement with the terms of the agreement.
5. A lorry acquired in February 2015 had met with an accident and it was fully destroyed. The market value of the lorry has been paid to the company by insurance company .
6. The IT software in use as at 1st April 2016 had been developed by the sri lankan software company in June 2015.
7. The machine was obtained under a finance lease agreement in July 2015, for a period of 48 months. Rental value of the agreement is Rs. 50,000/- and during the year entire rental was paid. This machine was not included on PPE schedule provided.
8. Unless stated otherwise, all items of Property, Plant and Equipment as at 1st April 2016 have been acquired in July 2014.

Note 2

Details of some of the expenses charged and income credited to income statement in arriving at the net profit for the year ended 31st March 2017 were as follows:

1. Summary of other income:

	Rs.
Insurance receipt on condemned lorry	2,000,000
Dividend received from a Company	90,000
Profit on sale of photo copy machine	40,000

2. Details of Interest expenses are as follows:

	Rs.
Over draft interest	2,700,000
Leasing Interest	325,000
Loan Interest	2,700,000

3. The company has made donations amounting to Rs.780,000/- to the Government Hospital and Rs. 100,000/- to child house.

4. Management fee was Rs.3,500,000/-, for the services recieved during the year.

5. Advertising costs:

	Rs.
Paper notices for supplier registrations	110,000
Sales promotion	1,200,000
Advertisements in electronic media	1,700,000

6. Total expenses to Research and Development was Rs. 750,000. The above amount included cost of the equipment amounting to Rs. 300,000.

7. A legal expense of Rs.85,000/- has been incurred for the recovery of bad debts and Rs. 15,000/- of legal fee was paid to lawyer regarding the case filed by the local authority.

8. Foreign travelling expense of the director to participate at the convocation of his son, amounting to Rs.550,000/- was charged to the Profit and Loss account. In addition to that Rs. 1,600,000/- was incurred to visit supplier warehouse in India. Taxable profit for the year of assessment 2015/16 was Rs. 40 million.
9. Finance Director of the company was provided a house for which monthly rent of Rs. 600,000 has been paid to the owner. Rental value of the house was Rs. 180,000. Monthly salary of the director was Rs. 250,000.
10. Details of bad debts charged to Income Statement amounting to Rs. 273,000 were as follows:
- | | |
|--|-----------------|
| | Rs. |
| Specific Provision | 95,000 |
| General Provision | 203,000 |
| Recovery of staff loan written off last year | <u>(25,000)</u> |
| | <u>273,000</u> |
11. The company has made a provision for gratuity of Rs.1,000,000/- for the year and a payment of Rs.650,000/- was made during the year as gratuity.
12. The company has paid a Royalty of Rs.600,000/- for the year.

Note 3

Economic Service Charge (ESC) paid for the period was Rs.1,200,000/- and self assessment tax payments for the year of assessment 2016/17 were Rs.810,000/-.

Note 4

During the year, Rs. 6,000,000 of dividend has been declared and dividend tax was paid on due date.

Required:

Prepare the following for the Hill Towers (Pvt) Ltd for the year of assessment 2016/17

- a. Statutory Income from each source of income,
- b. Total Statutory Income,
- c. Assessable income,
- d. Taxable Income,
- e. Gross Income Tax payable,
- f. Balance Income Tax payable or Refund due,

(Ignore implications of VAT, NBT and tax on under-distributed profit).

(Total 40 Marks)

Question No. 04

Zigma International PLC is a resident company engaged in Manufacturing of rubber products. Net profit of the company as per the Income statement for the year of assessment 2015/16 was Rs. 57,675,000/-.

Following further information was provided to you,

- Amount of Rs. 3,500,000 was distributed as liable dividend and dividend tax paid on due date.
- Notional loss of Rs. 1,050,000 on revaluation of the Building was deducted in arriving at above profit.
- During the year, Rs. 7,500,000 worth of assets were purchased and Rs. 1,500,000 has been charged as depreciation of such acquired assets.
- Tax on Taxable income for the Year of assessment 2015/16 was Rs. 5,600,000

Required:

- a. Compute the distributable profit based on profit for the year of assessment 2015/16.
(05 Marks)
- b. What is the quantum of minimum dividend required to be distributed before September 30, 2016 to avoid the tax on distributable profit.

(01 Mark)

- c. If dividend has not declared, what would be the tax payable on distributable profit at the point of tax calculation related to year of assessment 2016/17.

(02 Marks)

- d. On which situations, Tax on distributable profit will not be required to pay by Company, though there is a distributable profit and dividend has not been declared.

(02 Marks)

(Total 10 Marks)

Question No. 05

- a. What is the time of supply in following situations.

- i. Goods were delivered on 28.12.2016 and the invoice was issued on 10.01.2017.
- ii. Goods were delivered on 28.12.2016 and the invoice was issued on 05.01.2017.
- iii. Advance was received on 28.12.2016 and Goods were delivered on 06.03.2017.
- iv. The Commissioner General has approved to account on payment basis (cash basis) and the supply was made on 28.09.2016 and cash received on 15.12.2016.

(04 Marks)

- b. Inspiro International (Pvt) Ltd is a VAT registered person and engage in manufacturing and sales in Sri Lanka. Total taxable supply excluding VAT for the quarter ended on 31st March 2017 is Rs.106,000,000.

The following is a breakup of the purchases exclusive of VAT, wherever applicable, for the above taxable period.

Local Purchases:

Machinery from VAT registered persons	Rs. 2,327,000
Furniture from VAT not registered persons	Rs. 140,000
Expenditure incurred from VAT registered persons	Rs. 4,200,000
Expenditure incurred from persons not registered for VAT	Rs. 3,550,000

Imports:

Input tax on import a Machinery	Rs. 800,000
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sum of Rs. 200,000/- was available as unabsorbed brought forward input tax and amount of Rs. 500,000/- was made as instalment payment during the first two months of the quarter.

Required:

Calculate the output tax of the company and the input tax that could be claimed against the output tax for the quarter ended 31.03.2017.

(10 Marks)

c.

- i. Panther (Pvt) Ltd. is carrying on a business of wholesale and retail business. Turnover of the company for the quarter ended 31st December 2016 was Rs.10.5 million. NBT of Rs. 50,000 was paid during the quarter through monthly instalments.

Required:

Compute the Nation Building Tax payable for the quarter ended 31st December 2016.

(03 Marks)

- ii. Power World (Pvt) Ltd is in the business of manufacturing artificial plants. You are the tax consultant of Power World (Pvt) Ltd. Turnover of the company for the quarter ended 31st December 2016 is Rs.65 million.

Required:

The management request from you as Tax consultant, to advise them on the possible tax implication on Economic Service Charge (ESC) and eligibility to set-off against the Income Tax Liability.

(03 Marks)

(Total 20 Marks)

Question No. 06

Kandy City Sports Club has been formed in 2005 in Kandy and now there are nearly Five hundred members. The club has the facilities for both indoor and outdoor sports events and by hiring those facilities they earn extra income.

Following details about cash receipts and payments were extracted from the cash book of the club in respect of the year ended 31st March 2017.

- Entrance fees and subscription received were Rs. 500,000/- and Rs. 2,350,000/- respectively.
- Earned from the indoor sports activities is Rs. 900,000/- and from outdoor sports activities is Rs. 700,000/-. 40% of such income received from non members.
- Further club has incurred Rs. 80,000/- as electricity, Rs. 100,000/- as building maintenance and salaries paid to staff is Rs. 110,000/-.
- The club is operating a bar to earn an extra income.

The bar is open for both members and the outsiders. 60% of the bar sales during the year represents sales to the members of the club. Total sales during the year was Rs. 2,650,000.

Expenditure on the bar activities is amounting to Rs. 1,214,200/-.

- During the year, cash donation received from members was Rs. 200,000
- Gross interest on fixed deposit of Rs. 360,000/- was received during the year.

Required:

Compute the income tax payable by the club for the year of assessment 2016/2017.

(Total 10 Marks)