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

# **SUGGESTED SOLUTIONS**

**KC 3 - Corporate Taxation**

**December 2017**

# SECTION 1

## Answer 01

Relevant Learning Outcomes:  
5.4 Tax Planning  
6.4 Professional risk  
3.1 Statutory Provisions

### Suggested Detail Answer:

(a) (i) **Applicability of the concessionary rate of 10% for the income earned from conducting seminars**

As per item 32 of the Fifth Schedule to the Inland Revenue Act, the rate of income tax applicable to profits and income from educational services provided by a company, is 10 *per centum*.

As per the given facts this particular income from conducting seminars is to provide information (awareness programs) in order to get students is not treated as educational services. Further, the organizers of seminars are not providing any educational service.

However if the conducting of the seminar is solely carried out for **educational purposes** then there is no restriction to treat it as educational income.

As this is done in the form of awareness the 10% concessionary rate specified on educational income cannot be applied on profits & income from conducting this seminar.

Despite the above, conducting seminars falls within the meaning of “undertaking” under Section 59B as it engages in providing a kind of a service which does not exceed turnover of Rs. 300 Million (Applicable to the period from 1/4/2011 to 31/3/2013).

Therefore for Profits & Income from conducting seminars a 10% concessionary rate specified under section 59B could be applied.

(ii) **Applicability of the VAT Exemption**

In terms of item (i) (a) (2) of paragraph (b) of PART II of the First Schedule to the VAT Act No 14 of 2002, as amended by Amendment Act No. 9 of 2011 the supply of educational services provided by any person or partnership with effect from January 1, 2011, is exempt from VAT.

The VAT Act, defines “educational services” to mean the provision of services by any person or partnership in relation to education, vocational training or retraining.

As explained above, the supply of service from conducting seminars does not fall within the definition of educational services. Accordingly the VAT exemption is not applicable for conducting seminars and is subject to VAT at the appropriate rates.

(iii) **Non-Chargeability of NBT**

An educational service has not been exempted from NBT.

However, in terms of section 3(4)(iv) of the NBT Act No 9 of 2009, the liability does not arise, if the liable turnover of a person, providing educational services by any institution established locally for the purpose does not exceed the sum of twenty five million rupees per quarter.

Accordingly, the turnover from conducting seminars is liable to NBT.

As the total receipts of the company exceed the ceiling of Rs.25 million the company is liable to NBT on its total turnover which includes receipts from conducting seminars.

As the Company has not paid NBT there could be assessment issued and a penalty could be imposed due to non compliance with the relevant statute.

(iv) **Validity of the assessments**

The assessments could be issued within the stipulated time periods given below.

**Income tax:** In terms of section 163(5) of the Act which was amended in 2013 in respect of the period commencing before April 1, 2013, the time period is two years from the 30<sup>th</sup> day of November of the immediately succeeding year of assessment. Since the assessment was raised in June 2015, assessment is valid.

**Value Added Tax:** The assessments can be issued on or before three years from the end of the relevant taxable period. The assessments relating to all four quarters are valid since they have been issued before three years from the end of the relevant quarter. The law has a provision to issue assessments considering one or more taxable periods. Therefore, the assessments are valid.

**Nation Building Tax:** In terms of section 8 of the NBT Act the time bar period is 2 years from the end of the relevant quarter. As the assessments have been issued after 2 years from the end of the respective relevant quarters none of the assessments relating to NBT are valid.

- (b) **In terms of section 204A**, it is specifically stated that if **any auditor or tax practitioner who in the discharge of his professional duty**, deliberately misinterprets any provisions of this Act or any other Act administered by the Commissioner- General, or regulation, rule or order made there under shall be guilty of an offence under this Act and on conviction after summary trial before a Magistrate, be liable to a fine not exceeding rupees fifty thousand or to imprisonment of either description for a term not exceeding six months or to both such fine and imprisonment.

Moreover **In terms of subsection (4) of section 202 and subsection (1) of section 204** of the Inland Revenue Act generally states that **it applies for every person** and those who do such kind of acts without reasonable excuse could get penalized in the following manner;

*Shall be guilty of an offence under this Act, and shall be liable on conviction after summary trial before a Magistrate, to a fine consisting of*

- (i) *a sum equal to the amount of tax which had been undercharged in consequence of such incorrect return, statement, or information or would have been so undercharged if such return, statement, or information had been accepted as correct.*

- (ii) *A sum equal to the amount of tax so evaded or attempted to be evaded for which he, or as the case may be, the other person so assisted, is liable under this Act, for the year of assessment in respect of or during which the offence was committed.*
- (ii) *a sum not exceeding ten thousand rupees or to imprisonment of either description for a term not exceeding six months, or to both such fine and imprisonment.*

**(c)**

In terms of section 113 of the Act, any income tax of which any person or partnership is liable to pay for any year of assessment has to be paid in four quarterly installments on a self-assessment basis is as follows;

**On or before 15<sup>th</sup> August,  
On or before 15<sup>th</sup> November  
On or before 15<sup>th</sup> February** } **of the same year of assessment**

**And**

**On or before 15 May - of the following year of assessment**

The subsection (3) of section 173 of the Act, imposes a penalty for any tax in default as follows.

**For the first month a penalty of 10% of such default tax, and thereafter, 2% for each and every month subject to a limitation of 50% of the taxes in default.**

However it also states that if one fourth of the income tax payable of the previous year of assessment is paid on the due dates as quarterly payments and if any balance tax payable for that year of assessment could be made on or before 30 September of the following year of assessment without attracting any penalty.

**(Total: 25 marks)**

## Answer 02

### Relevant Learning Outcomes

- 2.1 Assessing income tax liability of a non-resident person
- 2.3 Double tax treaties
- 1.3 Personal taxation

### Suggested Detail Answer:

- (a) (i) As per the judicial decision made in the case of **Anglo Persian Oil Company Vs Commissioner of Income Tax** it is a well settled principle that business is transacted in a location where the agreement or the contract relating to the transaction is made. Applying this principle to the sales made based on the contracts entered into by BCMC China and the respective companies (customers) in their respective countries one would conclude that the profits are arising outside Sri Lanka since the contracts made in respect of such sales are made outside Sri Lanka. However, this principle has been superseded by section 84 of the Inland Revenue Act No 10 of 2006 (Act) which is reproduced below.

*“Where a non-resident person carries on in Sri Lanka any agricultural, manufacturing or other productive undertaking, and sells any product of such undertaking outside Sri Lanka or for delivery outside Sri Lanka, whether the contract is made within or outside Sri Lanka, the full profit arising from the sale in a wholesale market shall be deemed to be income arising in or derived from Sri Lanka, within the meaning of section 2:*

*Provided that, if it is shown that the profit has been increased through treatment other than handling, blending, sorting, packing and disposal of the product outside Sri Lanka, such increase of profit shall not be deemed to be income arising in or derived from Sri Lanka.*

*Where any such product is not sold in a wholesale market, or is not sold at all, such person shall be deemed to derive profits from Sri Lanka within the meaning of section 2, and such profits shall be deemed to be not less than the profits which might have been obtained, if such person had sold such product wholesale to the best advantage.”*

Accordingly, such sales should be accounted in the books of the Sri Lanka branch (as is done in this case) and income tax should be paid on the full profits arising from such sales.

(ii) Similarly the full profit arising from the sale of seat belts at cost to BCMC - China and other plants owned by BCMC China to be installed in used cars owned by them is liable to income tax in Sri Lanka based on above provisions and the Article 7(3) of the DTA between Sri Lanka and China which is reproduced below.

*“where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.”*

- (b) Considering the above provision, the profits and income of Biyota Car Manufacturing Ltd – Sri Lanka Branch which is a not resident company has been recomputed as follows.

**Biyota Car Manufacturing Ltd**  
**TIN: 123456789**  
**Year of Assessment 2016/2017**  
**Computation of Income Tax**  
**(Based on statutory accounts for the year ended 31 December 2016)**

	Note	Rs.
Net loss before taxation - As per the books of accounts		<b>(118,000,000)</b>
Deemed additional profit	1	250,400,000
Deemed net profit before taxation		<b>132,400,000</b>
<b>Add</b>		
Head office expenses		46,000,000
Royalty paid to Head office		32,000,000
Interest paid to Head office		98,000,000
		<b>176,000,000</b>
Adjusted taxable profit before head office expenses		<b>308,400,000</b>
Less: Head office expenses allowed	2	12,000,000
Adjusted taxable profit after head office expenses		<b>296,400,000</b>
<b>SUMMARY OF SOURCES OF INCOME</b>		
Profit from business		296,400,000
<b>Total statutory income</b>		<b>296,400,000</b>
Deduction from statutory income		-
<b>Assessable income/Taxable income</b>		<b>296,400,000</b>
Income Tax payable on export income at 12%		35,568,000
Remittance tax payable	3	36,500,000
<b>Total tax payable</b>		<b>72,068,000</b>

Note 1: Deemed Additional profit	Cost of sales as per statement of income	Percentage understated	Profit understated	
Export of car seat belts to all the plants of BCMC - China for newly manufactured cars	4,000,000,000	6	240,000,000	
Export of car seat belts to be installed in used cars owned by BCMC-China as well as by other plants owned by BCMC-China	60,000,000	16	9,600,000	
Export of car seat belts to third party customers in other countries to be installed in used cars	400,000,000	-	-	
Export of tyres for forklifts used in manufacturing plants in China and other countries	10,000,000	8	800,000	
<b>Total</b>	<b>4,470,000,000</b>		<b>250,400,000</b>	

<b>Note 2 - Head office expenses allowed</b>			
Adjusted taxable profit before head office expenses		308,400,000	
10% of total adjusted taxable profits <b>(A)</b>		30,840,000	
Head office expenses charged to P/L	46,000,000		
Less Head office expenses not related to the production of income of the Sri Lanka branch	(34,000,000)		
Head office expenses related to Sri Lanka branch <b>(B)</b>	12,000,000		
Head office expenses allowed <b>(lower of A and B)</b>		<b>12,000,000</b>	

<b>Note 3 - Remittance tax payable</b>		
Profits remitted from the year of assessment 2014/15	150,000,000	
Profits remitted from the year of assessment 2015/16	120,000,000	
Sales proceeds of products exported by the Sri Lanka branch retained abroad	95,000,000	
Total remittances made during the year	365,000,000	
Remittance Tax at 10%	36,500,000	

- (c) In terms of section 79 (2) of the Act an individual who is physically present in Sri Lanka for one hundred and eighty three days or more during any year of assessment, shall be deemed to be resident in Sri Lanka throughout that year of assessment. Accordingly Nimal Perera is deemed to be a resident of Sri Lanka in the year of assessment 2016/17 as his presence in Sri Lanka was 183 days. Therefore he will be subject to income tax on his world income in terms of the charging section (section 2) of the Act.

Also in terms of the Article 16 (Dependent Personal Services) Sri Lanka – Vietnam DTA, a resident of Sri Lanka has to fulfill all three conditions set out below for not to be liable to tax in Vietnam in respect of an employment exercised in Vietnam.

- (i) Sri Lankan is present in Vietnam for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned; and
- (ii) the remuneration is paid by, or on behalf of, an employer who is not a resident of the Vietnam; and
- (iii) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in Vietnam.

Even though Nimal fulfills the first condition the other two conditions are not fulfilled. Accordingly as a non-resident Nimal would be liable to income tax in Vietnam only in respect of the profits and income arising in or derived from Vietnam.

Accordingly Nimal gets taxed on his Vietnam income in Sri Lanka as well as in Vietnam.

However Nimal can claim a relief in Sri Lanka by way of a tax credit in terms of Article 24(3) Sri Lanka – Vietnam DTA which is reproduced below.

*“Where a resident of Sri Lanka derives income from Vietnam which in accordance with the provisions of this Agreement may be taxed in Vietnam, the amount of Vietnamese tax payable in respect of that income shall be allowed as a credit against the Sri Lanka tax imposed on that resident in respect of that income. The credit shall not, however, exceed that part of the Sri Lanka tax which is attributable to such income.”*

Further if required conditions are met Nimal can claim an income tax exemption in terms of the section 8(1)(j) of the Act which is reproduced below.

*“the emolument earned or the pension arising in any year of assessment, in foreign currency, by or to any individual resident in Sri Lanka in respect of–*

- (i) services rendered by him in that year of assessment; or*
- (ii) past services rendered by him or his spouse,*

*outside Sri Lanka in the course of any employment carried on, or exercised by him or his spouse, if such emoluments or pension are paid to him in Sri Lanka or such emoluments or pension (less such amount expended by such individual outside Sri Lanka as is considered by the Commissioner-General to be reasonable expenses) are remitted by him to Sri Lanka;”*

- (d) As per the VAT Amendment Act No. 20 of 2016, with effect from 2-5-2016, wholesale and retail is chargeable to tax if the total value of supply is more than 12.5 million for any three consecutive months. Since Dias is having around 15 million of value of supply for three consecutive months, he is required to get the registration for VAT.

However, the liability **arises only** with effect from 1-11- 2016, and he can claim deemed input credit on his opening stock as at November 1-11- 2016. Further, after obtaining the registration he can claim input tax on his purchases and deemed input tax credit on purchases made from non-registered persons while paying output tax on his supply.

**(Total: 25 marks)**



### Answer 03

Relevant Learning Outcomes:

- 1.2 Impact of Taxation on business and finance decisions
- 3.2 Case Law
- 6.3 Taxation and ethics
- 4.4 Managing VAT in a business

(a) **Quickpharma(Pvt) Ltd**  
**Year of Assessment 2016/2017**  
**Computation of Income Tax**

	Note	Rs.
Net profit before tax		6,312,082
<b>Add</b>		
Depreciation		20,000,000
Advertisement (1,300,000-170,000)* 25% +120,000		402,500
Loss on Disposal of Fixed Assets (Accounting)		1,925,000
Provision for slow moving stocks		5,710,000
Repair Expense relates to floor area given on rent		300,000
Foreign Travelling	2	2,012,000
Entertainment		658,000
Business promotion (1,250,000 * 25%)		312,500
Donation		620,000
Bank Loan Interest on acquisition of Fixed Assets-Allowed		-
Legal Fees		-
Imputed interest cost charged for deferred settlement scheme		525,475
Provision for gratuity	5	3,000,000
		<b>35,465,475</b>
<b>Less</b>		
Rent Income		1,847,000
Dividend income		1,800,000
Profit from sale of land		3,353,000
Gratuity paid		3,569,302
Loss on Disposal of Fixed Assets (Tax)	3	1,280,000
Depreciation allowance	4	22,059,167
10% of the intangible asset acquired in the Y/A 2016/17		350,000
Stocks written off		4,000,000
		<b>38,258,469</b>
Adjusted profit for tax purposes		<b>3,519,088</b>
<b>SUMMARY OF SOURCES OF INCOME</b>		
Profit from business		3,519,088
Rent income (Part of Profit from Business)	1	1,607,000
Total statutory income		5,126,088
Deduction from statutory income		
Tax Loss brought forward from the Y/A 2015/16	12,625,300	
Less: 35% of the statutory income	1,794,131	(1,794,131)
Tax Loss carried forward to the Y/A 2017/18	10,831,169	
Assessable income		3,331,957
Less: Qualifying payments		(620,000)

Taxable income		2,711,957
Income Tax payable @28%		759,348

#### Note 1 - Rent income

Gross rent received	1,847,000
Less: Rates	-
Repair expenses paid - Limited to 25% of the gross rent received	(240,000)
Rent income liable to tax	<b>1,607,000</b>

#### Note 2 - Foreign Travelling disallowed

Overseas travelling and accommodation	2,150,000
Less: air tickets provided to doctors as incentives	(350,000)
Overseas travelling relates to business	1,800,000
Profit adjusted for tax purpose of the previous year	6,900,000
2% of above - 26 (1) (c) (B)	138,000
Amount allowed (whichever is lower)	138,000
<b>Balance disallowed</b>	<b>2,012,000</b>

#### Note 3 - Tax (Loss)/gain on Disposal of Fixed Assets

Description	Year Of Purchase	Cost	Claimed	Tax WDV	Sales Proceed	Taxable Profit	Years	Rate
2 Delivery vans	2015/16	8,600,000	1,720,000	6,880,000	5,600,000	(1,280,000)	1	20%
<b>Tax(Loss)/gain on Disposal of Fixed Assets</b>						(1,280,000)		

#### Note 4 - Depreciation Allowance

	Year	Cost LKR	Rate %	Amount LKR
<b>Description</b>				
<b>Depreciation allowance for the year 2016/17</b>				<b>10,000,000</b>
Add: Depreciation allowance on additions during the year 2016/17				
Buildings	2016/17	30,000,000	0.10	3,000,000
Computer hardware	2016/17	5,000,000	0.25	1,250,000
Computer software - not locally developed	2016/17	2,500,000	0.25	625,000
Network accessories	2016/17	2,950,000	0.25	737,500
Other equipment (fridges/generators etc.)	2016/17	12,500,000	0.33	4,166,667

Furniture & Fittings	2016/17	20,000,000	0.20	4,000,000
		<b>72,950,000</b>		<b>13,779,167</b>
Less: Depreciation allowance on disposals during the year 2016/17				
2 Delivery vans	2015/16	8,600,000	0.20	1,720,000
				<b>1,720,000</b>
Less: Depreciation allowance on assets which were fully depreciated during the year 2016/17				
Assumed none of the assets were fully tax depreciated as at 31-3-2016				-
				-
<b>Depreciation allowance for the year 2015/16</b>				<b>22,059,167</b>

#### Note 5: Retirement Benefit Obligation

Balance as at 31-3-2016	15,604,191
Provision for the year	3,000,000
	<b>18,604,191</b>
Payments	3,569,302
Balance as at 31-3-2017	15,034,889

(b)

**Quickpharma(Pvt) Ltd**

**TIN: 123456789**

**Year of Assessment 2016/2017**

**Computation of Deemed Dividend Tax Liability for the Y/A 2016/2017 to be reflected in Y/A 2017/2018 Return of Income**

Book profit before taxation Y/A 2016/2017		6,312,082	A
Add	Depreciation on capital asset acquired during the Y/A 2016/2017	13,850,000	B
	Notional loss computed on the basis of a revaluation of any capital asset	-	
Less	Income tax payable for the Y/A 2016/2017	(759,257)	
	Notional profit computed on the basis of a revaluation of any capital asset	-	C
	Cost Capital asset acquired during the Y/A 2016/2017	(72,950,000)	
<b>Distributable profit for the Y/A 2016/2017</b>		<b>(53,547,175)</b>	<b>A+B-C = D</b>

<b>Total cost and accounting depreciation of the assets purchased during the Y/A 2016/17</b>			
<b>Type of Asset</b>	<b>Cost</b>	<b>Depreciation %</b>	<b>Depreciation</b>
Buildings	30,000,000	5%	1,500,000
Computer hardware	5,000,000	50%	2,500,000
Computer software - not locally developed	2,500,000	50%	1,250,000
Network accessories	2,950,000	50%	1,475,000
Other equipment (fridges/generators etc.)	12,500,000	25%	3,125,000
Furniture & Fittings	20,000,000	20%	4,000,000
	<b>72,950,000</b>		<b>13,850,000</b>

(c) As per the prevailing provisions of the Inland Revenue Act, Capital gain is not a taxable source.

However in terms of section 217 of the Inland Revenue Act, "trade" has been defined to include every adventure or concern in the nature of trade. Accordingly, it includes profit from isolated transaction when such transaction is in the nature of trade.

As per the Ram Iswara Vs CIR it was held that,

- as the transaction is concluded within a short period of time,
- as there was a preparation to sell the land dividing the land into lots and sketch was prepared to show the prospective buyers and
- the presence of profit motive

are characteristics of the nature of trade. Accordingly, dominant intention is not to live near St. Bridget's convent to facilitate children's schooling. It was held the transaction is as an adventure in the nature of trade hence is taxable.

However it could be argued that the transaction relating to the sale of land is an "isolated transaction". The profit arising from such a transaction could have been treated as a profit from trade if the transaction was an "adventure in the nature of trade". An adventure in the nature

of trade is undertaken with a profit motive. In the present case the land has been acquired to construct a pharmacy outlet and not with an intention of reselling at a profit. It was sold in changed circumstances; soon after the disagreement between two brothers). That does not make it an adventure in the nature of trade. Therefore, the profit arising is a capital profit and not a trading profit. Hence, the Profit on the sale of the land is not liable to tax. (Authority - Speldewinde vs. C. S. de Soysa). Also refer item (j) of section 3. The land is an asset for which tax depreciation is not granted. Accordingly any profit arising from the sale of the land is not subject to income tax and any loss is not deductible for tax purposes.

- (d) As per the Part II of the First Schedule to the VAT Act, import or supply of crutches, wheel chairs, pharmaceutical products, drugs other than cosmetics is exempt from VAT. Accordingly, sale of non-pharmaceutical items and cosmetic items are liable for VAT.

Hence the Assistant Commissioner's view is correct and the entire sale is not exempt from VAT and the company has to pay VAT on the sale of non-pharmaceutical items and cosmetic items.

In terms of section 22 of the VAT Act, input tax is deductible only on expenditure attributable to taxable supplies and not on exempt or excluded supplies. Any common input tax should be calculated on a pro rata basis using an appropriate criteria such as turnover, square area etc.

Accordingly, the company cannot claim any input tax in respect of the related expenses attributable to the pharmaceutical supply as it is an exempt supply for VAT purposes and the applicable portion of input tax on pharmaceutical supply cannot be claimed. Hence the Assistant Commissioner's view is correct and the VAT should be paid.

If the turnover arising from the sale of grocery items purchased locally is less than 100 Mn per quarter during the Y/A 2015/16, the company is not liable to pay VAT on such grocery sales.

- (e) In terms of Section 104A any profits and income arising, derived or accruing from, or any loss incurred in any domestic transaction entered into between two associated undertakings should be ascertained having regard to the arm's length price.

As per regulation 13 (1) of TP Gazette No 1823/5 of 12-8-2013 where one undertaking is controlled by an individual or jointly by such individual and his relative, and the other undertaking is controlled by himself or his relative or jointly by himself and his relative or jointly by his relatives, those two undertakings will be considered as associated undertakings and expected to transact at arm's length.

Also in terms of regulation 14 no corresponding adjustment will be available to the other undertaking in the event one undertaking had to pay any additional taxes arising from a transfer pricing adjustment.

Accordingly going forward it is advisable to transact with the undertaking owned by the chairman's wife having regard to the arm's length price.

**(Total: 50 marks)**

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