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THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE3 (A) – Fundamentals of Taxation

September 2018

SECTION 1

Answer 01

1. (a)

1.1

Relevant Learning Outcome/s: 2.1.2.

Explain the "chargeability" of income tax to a "person" under the "charging section" of the Inland Revenue Act.

Study text reference: Page 18-19

Correct Answer : D

1.2

Relevant Learning Outcome/s: 2.2.1.

Calculate "statutory income" from a small or medium-scale" trade, business, profession or vocation taking into consideration "allowable and disallowable expenses, capital allowances" and disposal of capital assets.

Study text reference: Page 29-37,55

Correct Answer : A

1.3

Relevant Learning Outcome/s: 3.1.5.

Explain the tax liability of a company on distributions.

Study text reference: Page 95

Correct Answer : A

1.4

Relevant Learning Outcome/s: 4.3.1

State the interpretations for tax purposes of the following terms , person, child, trade, business, executive officer and precedent partner

Study text reference: Page 116

Correct Answer : C

1.5

Relevant Learning Outcome/s: 5.1.1

Explain the applicability of VAT to small and medium-sized businesses along with the registration "threshold".

Study text reference : Page 122

Correct Answer : B

(Total: 10 marks)

1. (b)

1.6

Relevant Learning Outcome/s: 1.2
Tax System in Sri Lanka
Study text reference: Page 9
Correct Answer:
1. Department of Inland Revenue (Any one of the following) Income Tax , Value Added Tax, Nation Building Tax, Economic Service Charge, Stamp Duty under Stamp Duty (Special Provisions) Act
2. Provincial Departments of Revenue (Any one of the following) Betting Tax, Lottery Tax, Stamp Duty, Mineral Tax, Prize Competition Tax
3. Department of Customs Taxes on imports and exports
4. Department of Excise Excise Duty

1.7

Relevant Learning Outcome/s: 4.2.2
List the characteristics of a valid appeal and the steps of an "appeal settlement"
Study text reference: Page111
Correct Answer:
1. If he is dissatisfied with determination of the Commissioner General, he may appeal to the Tax Appeal Commission
2. If the appellant or the Commissioner General of Inland Revenue is <u>not satisfied</u> with the decision of the Tax Appeals Commission, either party may request the Commission, to commence a case, to obtain the opinion of the Court of Appeal on questions of law.
3. The next stage of appeal is to the Supreme Court. The decision of the Supreme Court would be final.

Relevant Learning Outcome/s: 4.4.5.

List recovery action available under the Inland Revenue Act

Study text reference: Page 114

Correct Answer:**(Any two of the suggested answers given below)**

1. Appoint a Tax Collector and recover tax by seizure and sale of movable property.
2. Take steps to collect tax from seizure and sale of immovable property, through District Court.
3. Take action before a Magistrate's Court, which can collect taxes as fine.
4. Issue notices to the following parties requesting them to pay such moneys directly to The Commissioner General.
 - Debtors
 - Any person holding money of the defaulter (including banks)
 - Any person holding money on account of some other person, to be paid to the defaulter.
 - Any person who has authority from the other person to pay money to the defaulter.
5. A person can transfer immovable property to the government in lieu of tax, if the Commissioner General so approves.
 - Issue notice to recover dues from the Employer.
 - In case of liquidation or bankruptcy, claim from the Liquidator, etc.

The Commissioner General can take action under more than one provision, if he believes that it is appropriate.

1.9

Relevant Learning Outcome/s: 5.1.4.
Explain the due dates of payment and submission of returns.
Study text reference: Page 129
<p>Correct Answer:</p> <p>In terms of section 26 of the Value Added Tax Act, Manufacturers are required to make monthly payments to the Department of Inland Revenue on or before the 20th of the subsequent month.</p> <p>Accordingly,</p> <p>October 2017 payment has to be made on or before November 20th 2017.</p> <p>November 2017 payment has to be made on or before December 20th 2017.</p> <p>December 2017 payment has to be made on or before January 20th 2018.</p> <p>VAT return for the quarter ended December 31, 2017 has to be filed on or before January 31, 2018</p>

1.10

Relevant Learning Outcome/s: 5.2.3.																																																
Compute tax payable in a straightforward, non-complex scenario.																																																
Study text reference : Page 138/139																																																
<p>Correct Answer:</p> <table border="1"> <thead> <tr> <th></th> <th>Liabe Turnover (Rs.)</th> <th>Less</th> <th>Balance L/T</th> <th>Rate</th> <th>Tax (Rs.)</th> </tr> </thead> <tbody> <tr> <td>Sale of Noodles</td> <td>8,460,000</td> <td>-</td> <td></td> <td>2%</td> <td>169,200</td> </tr> <tr> <td>Sale of Biscuits</td> <td>3,130,000</td> <td>75%</td> <td>782,500</td> <td>2%</td> <td>15,650</td> </tr> <tr> <td>Total</td> <td></td> <td></td> <td></td> <td></td> <td>184,850</td> </tr> <tr> <td>Tax credits</td> <td></td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>On import</td> <td></td> <td></td> <td></td> <td></td> <td>(92,000)</td> </tr> <tr> <td>NBT Paid on services - not allowed</td> <td></td> <td></td> <td></td> <td></td> <td>-</td> </tr> <tr> <td>Balance NBT payable</td> <td></td> <td></td> <td></td> <td></td> <td>92,850</td> </tr> </tbody> </table>		Liabe Turnover (Rs.)	Less	Balance L/T	Rate	Tax (Rs.)	Sale of Noodles	8,460,000	-		2%	169,200	Sale of Biscuits	3,130,000	75%	782,500	2%	15,650	Total					184,850	Tax credits						On import					(92,000)	NBT Paid on services - not allowed					-	Balance NBT payable					92,850
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(Total: 10 marks)

SECTION 2

Relevant Learning Outcome/s: 3.1

Basic understanding of income tax liability of a Resident Company (non-complex straightforward scenario)

Study text reference: Page 34/66/90/98

Answer 02

Mathurata Importers (Pvt) Ltd Computation of Gross Income Tax liability for the Year of Assessment 2017/18

		Rs.	Rs.
		+	-
Net Profit as per Accounts		1,425,000	
Less: Separate Sources of Income			
Interest income (Gross)			1,800,000
Foreign dividend			300,000
Add:			
Foreign Travel –	48,000		
Restricted to 2% Business Profit for previous year			
2,100,000 x 2%	(42,000)		
Disallowed	6,000	6,000	
Tools purchased	Disallowed	34,000	
Not entitled to renewal allowance in this year			
Lease interest		122,000	
Lease allowance			
Lease rental value (50,000 x 36)	1,800,000		
1/5 th of the Lease value	360,000		
Lease rental paid (50,000 x 11)	550,000		
Amount claimed (1/5 th or amount paid which ever lower)			360,000
Donation	Disallowed	300,000	
		1,887,000	2,460,000
Adjusted Loss from trade		(573,000)	

Computation of Income Tax Liability			
Adjusted business profit			Nil
Interest income			1,800,000
Dividend Income - foreign	Exempt		-
Total Statutory Income			1,800,000
Less: Statutory Deductions			
Loss for the year	573,000		
Restricted to 35% from TSI (1,800,000 x 35%)	630,000		
Loss claim for the year	573,000	(573,000)	
Assessable Income			1,227,000
Less: Qualifying Payments			
Donation to approved charity	Not entitled to claim, since made in kind (goods)		Nil
Taxable Income			1,227,000
Tax liability at 28%			343,560

(Total: 10 marks)

Answer 03**Relevant Learning Outcome/s:**

2.2 Statutory income from sources of profits & 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

Study text reference: Page 43/50/62-69/74

Mr. Perera**Y/A 2017/18 - Computation of Income Tax Liability, Tax Credit & Balance Tax Payable**

			Rs.
Sources of Income			
Employment income			
Gross Salary	160,000 x 12	1,920,000	
Actual fuel cost reimbursement	380,000		
Exempted up to Rs.50,000 per month	600,000		
Housing benefit			
Rating Assessment + Rates	390,000		
Gross Rent paid by the Employer	360,000		
Whichever is higher	390,000		
Maximum Taxable Rental Value as Remuneration exceeds Rs. 1.8 million	180,000		
Less : Rent paid by the Employee	108,000		
Therefore liable Housing Benefit		72,000	
Medical bill payment of Rs. 80,000 on account of injured caused during work	Not an employment benefit	-	
Credit Card Reimbursement on cost of official Rs. 162,000	Not an employment benefit	-	
Gift Received Rs. 100,000	Not Taxable	-	
Total employment income			1,992,000
Rent income			
Rental Value	300,000 + (300,000 *30%)	390,000	
Less: Rates		(90,000)	
		300,000	
Less: 25% Repairs Allowance		(75,000)	
Net Rent		225,000	225,000
Profit from Furnishing			
Gross Rent paid		420,000	
Less : Rental value		(390,000)	
		30,000	
Less : Upkeep expenses		(20,000)	

		10,000	10,000
Interest income	190,000 - 150,000		40,000
Dividend received - in foreign currency	Exempt		-
Business income			
Net Profit as per Accounts		990,000	
(Add/Less) Allowable / Disallowable Expenses			
Telephone & Electricity - Related to Residence	Not Allowed (572,000 x 85%)	486,200	
Purchase of Computer	Disallowed - capital nature	128,000	
Depreciation Allowance			
Computer	128,000 x 25%	(32,000)	
Accounting Profit from Disposal of Van		(580,000)	
Tax Profit on Disposal of Asset			
Sales proceeds	1,100,000		
Less: TWV (1,300,000 -(1,300,000 x 20% x 2)	780,000		
Tax profit on Disposal of Van		320,000	
Adjusted Profit from Profession			1,312,200
Statutory Income			3,579,200
Add : Child Income			
Ground Rent income			60,000
Total Statutory Income			3,639,200
Less: Statutory Deductions			
Annuity			(300,000)
Interest Paid on housing loan			(95,000)
Assessable income			3,244,200
Tax Free Allowance			(500,000)
Less : Qualifying Payments			
Employment Income Relief			(250,000)
Capital Repayment of loan, up to 600,000 is deductible for professional's housing loan			(270,000)
Taxable income			2,224,200
Tax liability			
First Rs. 500,000 at	4%	20,000	
Next Rs. 500,000 at	8%	40,000	
Next Rs. 242,000 at	12%	29,040	
Business Income U.S 59 B or U.S 59F	12%	117,864	
{(225,000 +10,000 +40,000 + 1,312,200 + 60,000) -(300,000 + 95,000 +270,000)}			
			206,904
Less: Tax credits			
PAYE			(140,000)
Balance Tax Payable			66,904

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