

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

15304–Advanced Taxation and Strategic Tax Planning

CA Professional (Strategic Level I) Examination
June 2014

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

Answer No 01.

(a)

Lanka Biscuits PLC
Computation of Taxable Income & Income Tax Payable
For the Y/A 2013/14

Sources of Income

				Rs.'000
Profit from Business- (Schedule-01)				479,083
Interest Income (405 + WHT 45)				450
Total Statutory Income				479,533
Deductions from TSI				-
Assessable Income				479,533
Qualifying Payments				
Investment in Expansion(Limited to 25% of Investment)		200,000		(50,000)
Taxable Income				429,533
Tax Liability				
Profit on Exports	(2,060/3,400) x (429,533-1,113-450)	259,299	@ 12%	31,116
(Export Turnover/Total Turnover)x (Profit from Business-Disposal of FA – Interest rate)				
On balance taxable income(429,533-259,299-1,113)		169,121	@28%	47,354
				78,470
Tax on Disposal of Capital Assets		1,113	@28%	312
Total Income Tax Payable				78,782
Tax on Dividends				
On Bonus Issue		200,000	@ 10%	20,000
Share Buy Back Dividends	Buy	100,000		
	Market Value	(90,000)	10,000 @ 10%	1,000
Tax on Dividend Distributed -				
Total Dividend		18,000		
Less: Gross Dividend declared out of Dividend Received		(1,000)		
		17,000	@ 10%	1,700
Total Tax Payable				101,482
<u>Less: Tax payments</u>				
Tax Credit for listing shares-Applied 50% reduction rate (other than profit on disposal)		(78,470 @ 50%)	(39,235)	
WHT on Interest			(45)	
Un-utilized VAT			(34,000)	
SA Payments			(12,000)	(85,280)
Balance Tax Payable				16,046

Schedule: 01**Adjusted Profit From Trade Y/A 2013/14**

	+	(-)
Net Profit / (Loss) Before Tax	428,550	
Less: Other Income		
Interest Received	-	(405)
Profit from Disposal of F/A	-	(650)
Dividends	-	(900)
<u>Add: Disallowed Expenses</u>		
Stamp Duty on Bonus Issue	1,000	
Stamp Duty on Public Issue	3,500	
Cost of Printing(Prospectus)	8,250	
Publication of Printing	26,000	
Underwriting Cost-CSE	7,000	
Professional Fees & Consultancy	6,000	
Share Issue Expenses (Listing) is limited to 1% of the initial Share Value		(7,000)
Office Building Repair (Limited to 25% of Gross Rent) Rs. 210		
Gross Rent -12,000 x 25% = 3,000 Allowed as within the limit	-	
Depreciation	78,000	
Entertainment	4,000	
Advertisement-Outside Sri-Lanka(Promotion of Exports)		
88,000 – 100% allowed	-	
Advertisement-in Sri-Lanka (25% Disallowed of 12,000)	3,000	
Provision for Bad Debts	34,500	
Provision for Gratuity	8,500	
Actual payment of Gratuity		(1,375)
Foreign Travel-Trade Fair & Exhibition-Allowed as promotion of Exports	-	-
Adjusted Profit on Disposal	1,113	
Capital Allowances on New Machinery-Used for expansion Hence 50% x 200,000		(100,000)
Research Expenses (Nominally Disallowed)	32,000	32,000
Less: Done through Singapore Institute	(22,000)	100% allowed (22,000)
Carried out through Sri Lankan Institute	10,000	300% allowed (30,000)
Damaged & Expired Stocks- No adjustment required		-
	<u>641,413</u>	<u>(162,330)</u>
	479,083	

Schedule: 02

Adjusted profit on Disposal

Sale Proceeds

Less: Tax WDV		1,700
Cost	2,350	
Capital Allowances claimed	<u>(1,763)</u>	<u>(587)</u>
Adjusted profit on Disposal		<u>1,113</u>

Computation of Distributable Profits

Book Profit As per the Financial statements	428,550
Income tax liability (As per the computation)	<u>(78,782)</u>
	349,768
Add:	
Depreciation for the additions-made during the year	<u>40,000</u>
	389,768
Less: Acquisition of Fixed Assets during the year	<u>(200,000)</u>
	<u>189,768</u>
Distributable Profit	<u>189,768</u>
10% Minimum Distribution as per Section 61	18,977
Company has already distributed	<u>(18,000)</u>
Balance to be distributed to avoid deemed dividend tax	<u>977</u>

(b)

Any company obtaining a listing in the Colombo Stock exchange on or after 1/4/2013 but prior to 1/4/2014 by way of initial public offering, not less than 20% of its issued shares to general public is entitle to enjoy reduction of 50% of the tax rate applicable to the Company for the Y/A in which such shares are listed and allows to enjoy the reduced rate for another two Years of Assessments immediately succeeding that Y/A subject to the following condition;

Company has to maintain the condition of “minimum 20% of shares to general public” for them to enjoy the applicable exemption for immediately succeeding two years.

However this reduction in tax rate is not applicable for Profits & Income on sale of capital assets of the company.

Answer No. 02

(a)

**Computation of Income tax liability of Mr. Asoka
For the Y/A 2013/14**

	Rs	Rs
<u>Sources of Income</u>	-Liable-	Exempt-
Employment Income		
Pension Income from Dubai	-	360,000
Income from Trade (Note-01)	-	-
Rent Income		
	<u>Net Rent</u>	
Gross rent (130 x 10)	1,300,000	
Less: Rates	<u>(56,000)</u>	
	1,244,000	
Less: 25% for repairs	<u>(311,000)</u>	
	<u>933,000</u>	
	<u>NAV</u>	
Rating Assessment	560,000	
Less: 25% for repairs	<u>(140,000)</u>	
	<u>420,000</u>	
For Comparison (420,000 x (10/12))	<u>350,000</u>	
Net Rent or NAV - whichever is higher	933,000	-
NAV of House Constructed		
Rating Assessment	600,000	
Less: 25% for repairs	<u>(150,000)</u>	
NAV of one house of is exempt	<u>450,000</u>	450,000
Dividend Income (Tax @ 10%)		
Dividend in a way of Buy back shares		
Sale Proceeds (50,000 @ 30/-)	1,500,000	
Less: Market Value of Shares on Resolution date (50,000 @ 25/-)	<u>(1,250,000)</u>	
Assumed WHT has not been deducted. Therefore this is taxable	<u>250,000</u>	250,000
Interest Income on Nations Building Bond (Us \$ 6,000 x 139/-)	-	834,000
Total Statutory Income	1,183,000	<u>1,644,000</u>
Less: Statutory Deductions		
Trade Loss cannot be claimed as relevant Profit is exempted under sect. (13)		
zzzzzzzz		-
Interest Paid on the housing loan (Acquisition of Land)	<u>(72,000)</u>	
Assessable Income	1,111,000	
Tax free allowance	(500,000)	

Qualifying payments

Qualifying payment on House constructed prior to 1/4/2011	(Note-02)	(100,000)
Housing Loan Capital-Not Allowed		-
Donation-Sick & Needy (1/3 of AI or 75,000/-whichever is lower)		<u>(30,000)</u>
Taxable Income		<u>481,000</u>

Computation of Tax liability

	481,000	4%	19,240
	<u>481,000</u>		<u>19,240</u>
Less: Tax Credits			
S A Quarterly Payments (4,000 x 4)			(16,000)
Balance Tax Payable/(Refund Due)			<u>3,240</u>

Income from Trade (Note-01)

Net Profit as per accounts		1,030,000
Add: Disallowed Expenses		
Advertisements 68,000 x 25%		<u>17,000</u>
		1,047,000
Less: Capital Allowances		
Construction of Building 14 Million x 10%		(1,400,000)
Investment on Equipment 9 Million x 33.33%		<u>(3,000,000)</u>
Adjusted Trade Loss		<u>(3,353,000)</u>

If there is a Profit it is exempted under sect. (13) zzzzzzzz

Hence the Trade Loss cannot be claimed limiting 35% of SI under Sec 32

Note-02**Qualifying payment on House constructed prior to 1/4/2011**

Cost incurred in 2004/05	15,000
Less: Qualifying payment for the year 2004/05	<u>(100)</u>
This was available for C/F for 9 years from 2004/05	14,900
Available for the Y/A 2013/14 (1/9)x 14,900	1,656
Subject to maximum 1/3 of AI or Rs. 100,000 1/3 of AI	370,333
Therefore claimed maximum	<u>100,000</u>

(b)

In the case of return of capital, such return of capital will be treated as dividend income to the extent of paid up value of any bonus share issued within 6 years by capitalizing profit.

Accordingly, return of capital other than the above instance, will not be treated as dividend income.

In the case of Asoka, he has received bonus shares in 2012. Therefore any return of capital within 6 years from the date of issue of such bonus shares will be treated as dividend income.

Answer No. 03

Within thirty days from the date of receipt of the determination, the company should convey to the Tax Appeals Commission its intention to appeal against the determination. With this communication, details of the authorized representative and a copy of the determination should be provided.

On receipt of reasons for the determination from the Commissioner General, the appeal to the Tax Appeals Commission should be lodged within thirty days from the date of receipt of the reasons.

The appeal should be in six copies.

The grounds of the appeal should be specified

The payment of a non-refundable amount of ten percent of the tax determined by the Commissioner General should be paid or twenty five percent of the tax determined by the Commissioner General should be paid or a bank guarantee for the twenty five percent should be provided. A further sum of Rs. 2,500 which is non-refundable should be paid.

The appellant should attend the hearing of the appeal in person or by sending an authorized representative.

On receipt of the determination of the Tax Appeals Commission, if the company disagrees with the determination and wishes to proceed against it, a request for a stated case on questions of law to be formulated by the appellant, should be made to the Tax Appeals Commission within thirty days from the date of receipt of the determination. When making the request, a sum of Rs 1,500 should be paid.

When the stated case is received from the Tax Appeals Commission, it should be filed with the Court of Appeal within fourteen days from the date of receipt of the stated case.

If he is dissatisfied with the decision of the Court of Appeal may take up an appeal before the Supreme Court involving in a substantial question of law.

Answer No 04

(a) The definitions of charitable institution and charitable purpose on the one hand and non-governmental organization on the other, are not the same. Non-governmental organizations providing relief for the needy may be charitable institutions engaged in relief of poverty. As the facts given in the sum shows more features of a NGO, the David Keller Foundation is to consider as a Non-Governmental Organization.

(b) **Computation of tax payable by David Keller Foundation for Y/A 2013/14**

Contributions received (Limited to 3% of Gross receipts) [68,930,530 @ 3%]	2,067,916
Interest on deposits with banks and financial institutions [2,874,000 x (100/90)]	3,193,334
Interest on government securities [1,780,000 x (100/90)]	1,977,777
Statutory Income	7,239,027
Less: Statutory deductions	-
Assessable Income	7,239,027
Less: Qualifying payments Investment in Venture Capital Co (more than Rs. 500,000/-) Limited to 1/5 of Assessable Income or 50% on Investment	(500,000)
Taxable Income	<u>6,739,027</u>
Tax Payable	
6,739,027 @ 28% tax	1,886,928
Less: Tax Payments	
W.H.T. on interest	319,334
Notional Tax Credit	<u>197,777</u>
Balance Tax Payable	<u>1,369,817</u>

Answer No 05

(a) **Tire House Ltd - VAT Computation**

Output VAT

Supply of Goods

Export of tyres manufactured	58,953,000 @ 0%	-
Export of tubes purchased	25,000,000 @ 0%	-
Local sales - Tyres	8,750,000 @ 12%	1,050,000
Local sales- Tubes (buying & selling)	<u>12,570,000 Not Liabile</u>	<u>-</u>
	105,273,000	1,050,000

Less: Input Tax

VAT on imports of raw materials	8,790,000	
VAT paid on Import of Raw Materials		
<u>“0” rated supply on raw materials x Input Vat</u>		
Total Supply		
<u>58,953,000</u> x 8,790,000		
67,703,000	100% Allowed	(7,653,972)
		(7,653,972)
		1,136,028
Balance Limited to 100% of Out Put Tax	<u>1,050,000</u>	<u>(1,050,000)</u>
Excess Input Tax C/F	<u>86,028</u>	
VAT on suspended Invoices-Manufacture of Tyres (Cannot claim)		
VAT on suspended Invoices-Export of Tyres (Cannot claim)		
Balance VAT – Refund Due		<u>7,653,972</u>

- (b) The company cannot issue VAT invoices on tube sales on which it is not liable to pay VAT. In such a situation, the company shall be guilty of an offence under **Section 67** of the VAT Act and shall be liable, on conviction after summary trial before a Magistrate, to a fine not exceeding Rs. 25,000 (twenty five thousand) or to imprisonment of either description for a term not exceeding six months or both such fine and imprisonment.

Answer No. 06

- (a) What is deductible in the computation of profits, in terms of Section 25 of the Inland Revenue Act, is expenditure incurred in the production of income.

The expenditure should be directly connected with the producing of profits. It should not be a remote connection (Ward & Company Ltd vs Commissioner of Income Tax-New Zealand).

Applying the statutory provision as interpreted in decided cases, the expenditure in question has no direct connection with the producing of profits. Therefore, it is not deductible.

- (b) Though the persons to whom the offer has been made are employees, the amounts offered are not for services rendered by them. Therefore, the amounts cannot be treated as employment income (Craib vs Commissioner of Income Tax).

The payment is to be made for restricting the rights and freedom of the two employees to exercise a trade or a profession after their retirement. Therefore, the amounts are non-taxable capital receipts in their hands.

- (c) “Income” has been defined as the result of either capital or labour. Though it is difficult to see whether the amount concerned is the result of capital or labour, it has certain characteristics of income, namely, recurrence and regularity. Therefore, it can be treated as income. At the same time, it falls within the definition of “annuity” and therefore, it is an annuity as well. It can also be treated as income from any “other source” (Authority- Incorporated Law Society vs Commissioner of Income Tax OR Tea Propaganda Board vs Commissioner of Income Tax).

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