THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA



# SUGGESTED SOLUTIONS

## 15304–Advanced Taxation and Strategic Tax Planning

CA Professional (Strategic Level I) Examination
December 2012

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

**Answer No. 01**

**(a)**

| | | | | |
|---|---|---|---|---|
| **Smart Chips Solutions (Pvt) Ltd** | | | | |
| **Computation of Profit from Business** | | | | **Sch.1** |
| | | | Rs.'000 | Rs.'000 |
| | | | + | - |
| Net Profit before taxation | | | 43,435 | |
| **Item Considered Separately** | | | | |
| Profit on disposal of Fixed Assets | | | | 135 |
| Trade Receipt/Tax Profit on Disposal | | Note 3 | 50 | |
| **Item Disallowed** | | | | |
| Staff Training - local workshops and seminars | | Allowed | | |
| Staff Training - Foreign workshops and seminars | | Allowed | | |
| Advertising | -at Trade fairs in Mexico and Dubai | Allowed | | |
| Advertising | -in Local magazine | 25% Disallowed | 25 | |
| Entertainment | | | 985 | |
| Foreign travelling-Promotion of Exports | | Allowed | | |
| Foreign travelling- for other purposes | | Note1 | 100 | |
| Interest on Lease | | | 1,700 | |
| Stamp Duty on Share issued during the year | | | 50 | |
| Royalties | | Note 4 | 2,000 | |
| Provision for Doubtful Debts | | Note 5 | 526 | |
| Accounting Depreciation | | | 2,424 | |
| Amortization | | | 750 | |
| Tax on General Manager Salary | | | 260 | |
| **Item Allowed** | | | | |
| Research Expenses (other than capital expenses) | | Double Deduction | | 1,000 |
| Research Expenses (other than capital expenses) | | Allowed | | |
| Research Expenses (capital expenses) | | Lab Equip | | 1,000 |
| Research Expenses (capital expenses) | | Computer | | 200 |
| Depreciation Allowance | | Note 2 | | 5,825 |
| Lease Rentals | | Note 6 | | 3,360 |
| Donation | | | 100 | |
| | | | 52,405 | 11,520 |
| **Adjusted Profit** | | | **40,885** | |

**Smart Chips Solutions (Pvt) Ltd**

| | | | | | |
|---|---|---|---|---|---|
| | Income From Trade or Business | | **Sch.1** | 40,885 | |
| | **TSI** | | | **40,885** | |
| | Less: Deduction Under S.32 | | | | |
| | Loss BF | Note 7 | 560 | | |
| | Limited to 35%ofTSI or loss which ever | | | | |
| | Royalties paid | Note 4 | 1,380 | (1,940) | |
| | **AI** | | | **38,945** | |
| | Less: Deduction Under S.34 | | | | |
| | QP | | | | |
| | Donation | | 60 | (60) | |
| | (20 % of AI or 500,000)<br>Donation-Cultural Event | Not allowed | | | |
| | **Taxable Income** | | | **38,885** | |
| | Taxation | | | | |
| | Tax on Taxable Income | 10% | 38,885 | 3,888 | |
| | Dividend Tax | 10% | 500 | 50 | |
| | Gross Income Tax | | | **3,938** | |

| | | | | |
|---|---|---|---|---|
| (ii) | **Computation of Distributable Profit** | | | |
| | | | | **Rs.000** |
| | *Book profit as per Income Statement* | | | 43,435 |
| Less: | Income Tax for the year | | | (3,888) |
| | *Acquisition of Capital Assets* | Tangible | 20,100 | |
| | | Intangible | 7,500 | |
| | | Improvements | - | |
| | | Lease Machinery | (10,000) | (17,600) |
| | *Capital WIP Not Deductible* | | | - |
| | | | | 21,947 |
| Add: | Depreciation on additions to PPE | | | |
| | As per accounts | | 3,174 | |
| | On previous Year | | (85) | |
| | On previous Year | | (100) | 2,989 |
| | **Distributable Profit** | | | 24,935 |
| | *Minimum Distribution To be made before 30.09.2012* | | 10% | 2,494 |
| | *Distribution already made* | | | (500) |
| | Balance Should have been Distributed | | | **1,994** |

**(b)**
As per the Section 94 of the Inland Revenue Act
*Where royalties are borne directly or indirectly by a person resident in Sri Lanka; or deductible under section 32, such royalties shall be deemed to be profits and income arising in or derived from Sri Lanka.*

As per the Section 39 of the Inland Revenue Act when it is paid to company, partnership or body of persons outside Sri Lanka, tax rate is applicable is 15% (5th Schedule). Where double tax agreement between the countries is exits, the rate in the agreement is applicable.

**Note 1** **Foreign travelling- for other purposes**

Trade Profit in 2010/11 - Nil
Therefore it is not allowable

**Note 2** **Depreciation Allowances**

| | | Rs. | | Rs. |
|---|---|---|---|---|
| **Year of Acquisition** | **Item** | **Cost** | **Rate %** | **Claim for the Year** |
| 2010/11 | Land - (No Depreciation allowance is claimable) | - | - | - |
| 2010/11 | Building-Factory | 8,000 | 6 2/3 | 533 |
| 2011/12 | Building-Additions- | 2,000 | no | |
| 2011/12 | Building-New | 1,500 | 10 | 150 |
| 2011/12 | Machinery & Equipment | 500 | 33 1/3 | 167 |
| 2011/12 | Delivery Van | 3,000 | 20 | 600 |
| 2011/12 | Office Furniture & Fittings | 1,000 | 20 | 200 |
| 2011/12 | Office Equipment | 600 | 33 1/3 | 200 |
| 2011/12 | Lab Equipment | 500 | Allowed under R&D | |
| 2011/12 | Computer Equipment (100 allowed under R&D) | 900 | 25 | 225 |
| 2011/12 | Machinery on Lease (No Depreciation allowance is claimable) | - | - | - |
| 2011/12 | Locally developed Software | 2,500 | 100 | 2,500 |
| 2011/12 | Internationally Developed Software | 5,000 | 25 | 1,250 |
| | | | | **5,825** |

No Depreciation Allowance on capital WIP

**Note 3** **Profit on Disposal of PPE**

| | | |
|---|---|---|
| Cost | 900 | |
| Depreciation | 85 | |
| WDV at the time Disposed | 815 | |
| Accounting Profit | 135 | |
| Sales Proceeds | | 950 |
| Less: Tax WDV | | (900) |
| Trade Receipt/Tax Profit on Disposal | | 50 |

Company is not the owner as at 31.03.12- Company cannot claimed Depreciation allowance at the end of the year

**Note 4** **Royalties**

| | |
|---|---|
| Royalties Due | |
| 1 % of the Turnover 200,000 | 2,000 |
| Payables as at 31.03.2012 | 620 |
| Paid during the year | 1,380 |

**Note 5** **Provision for Doubtful Debts**

| | |
|---|---|
| Net Amount-95% | 9,992 |
| Gross amount -100% | 10,518 |
| Provision for Doubtful Debts | 526 |

**Note 6** **Lease Rentals**

| | |
|---|---|
| Cost of the machinery | 10,000 |
| Rentals Paid | 4,200 |
| Total Lease Value | 16,800 |
| Maximum Claimable 1/5 of | 3,360 |
| claimed | 3,360 |

**Note 7** **Pre operational Expenses-Trade Loss B/F**

| | |
|---|---|
| Staff recruitment and Training made prior to commencement of Business | - |
| Cost of drawing, printing of articles and Other formation Expenses | 160 |
| Stamp Duty on Share Capital | 400 |
| Cost of the feasibility report made prior to commencement of business | - |
| Staff salaries of the administration staff | - |
| Office maintenance & Other expenses | - |
| Trade-Loss | **560** |

**Answer No.2**

**Part (a)**

**Mr. Ranwala**
**Computation of Balance Income Tax payable/Refund Claimed**
**Year of Assessment 2011/12**

| | | | | | |
|---|---|---|---|---|---|
| **Employment Income** | | | | | |
| Salaries - 180,000 *3 | | | | 540,000 | |
| Travelling allowance - 40,000 *3 | | | 120,000 | | Exempt |
| Exemption | | | | (40,000) | |
| *EPF* | | | | | |
| Member contribution | | | 2,419,200 | | Exempt |
| Employer contribution | | | 3,628,800 | | Exempt |
| Investment Income | | | 1,340,000 | | Exempt |
| ***ETF*** | | | | | |
| Employer Contribution | | | | 907,200 | |
| Investment Income after 1/4/1987 | | | 176,699 | | Exempt |
| Gratuity | | | | 2,310,000 | |
| ***Total Employment Income*** | | | | **3,717,200** | |
| Professional Fees - as a Liquidator | | | | | |
| | ABC | | | 750,000 | |
| | PQR | | | 1,350,000 | |
| Interest - 8% Tax deducted | | | | 8,500 | Subject to Final Tax |
| Partnership Profit | | | | 1,400,000 | |
| **Total Statutory Income** | | | | **7,225,700** | |
| Less: | Deduction under S.32 | | | | |
| | Interest | | | (8,500) | |
| **Assessable Income** | | | | **7,217,200** | |
| Less: | Deduction under S.34 | | | | |
| | Tax Free allowance | | 500,000 | | |
| | ***Qualifying Payments*** | | | | |
| | Insurance - Life | 300,000 | | | |
| | Donation | 85,000 | | | |
| | *(limited 1/3 AI or 75,000/-)* | | 75,000 | | |
| | Insurance - incurable disease | 120,000 | 120,000 | | |
| | Insurance - House | Not allowed | - | (695,000) | |
| **Taxable Income With terminal Benefits** | | | | **6,522,200** | |
| Less: | Terminal Benefits | | 3,217,200 | | |
| | Less: Terminal Benefit tax under Normal Rate (Note 2) | | (91,000) | (3,126,200) | |
| **Taxable Income excluding terminal Benefits** | | | | 3,396,000 | |

| | | | | |
|---|---|---|---|---|
| (Taxable under 1st Schedule) | | | | |
| Tax on the above | | | | |
| | 500,000 | 4% | 20,000 | |
| | 500,000 | 8% | 40,000 | |
| | 2,100,000 | 10% | 210,000 | (SME rate max:@ 10%) |
| | 296,000 | 12% | 35,520 | |
| On terminal Benefit (Note 3) | | | nil | |
| | **3,396,000** | | **305,520** | |
| **Tax Credits** | | | | |
| PAYE | | 32,415 | | |
| Self Assessment Tax | | 200,000 | | |
| Partnership Tax 1,400,000 *305,520 | | | | |
| 7,217,200 | | 59,265 | | |
| Paid 89,600 | | | (291,680) | |
| | | | | |
| Balance Payable now | | | **13,840** | |

| | | | | |
|---|---|---|---|---|
| **Note 1** | **Partnership Profit and Tax** | | | |
| Partnership Divisible Profit | | | 3,000,000 | |
| Tax Free Allowance | | | (600,000) | |
| Taxable Profit | | | 2,400,000 | |
| Partnership @8% | | | 192,000 | |
| Applicable to Mr. Ranwela | 1,400,000 / 3,000,000 | X 192,000 = | **89,600** | |

| | | | | |
|---|---|---|---|---|
| **Note 2** | **Gratuity Liable under Normal Rates** | | | |
| | Gratuity | | 2,310,000 | |
| | Maximum under Concessionary Rate | | | |
| | Average last 3 Years-Concessionary Rate | 105,667 | | |
| | Total Gratuity can be taxed under Concessionary Rate | | 2,219,000 | |
| | Liable At Normal Rates-Gratuity | | 91,000 | |

| | | | |
|---|---|---|---|
| **Note 3** | **Tax Terminal Benefits** | | - Period is more than 20 years |
| | First | 5,000,000.00 | nil |
| | Next | 1,000,000.00 | 5% |
| | on Balance | | 10% |
| | **No tax as less than the 5,000,000/-** | | |

**<u>Alternative Answer - Note 3</u>**

Rs.68,000 is also acceptable provided it is considered as subject to final tax .

**Part (b)**

Individual has to make an application to close the income tax file from records maintained by the CGIR on the basis that such individual is deriving income only from sources on which taxes are paid at source and such taxes are treated as final tax.If the CGIR satisfied on the application made, CGIR may close the record of the income tax file after 1/4/2011

**Answer No. 03**

(a) A person can be fined for furnishing an incorrect return, only where the assessment issued to him exceeds the amount of assessable income or taxable income stated in the return and the assessment becomes final and conclusive under the section 171,unless it is proved that the incorrect amounts are not due to fraud or willful negligence.

The fine is an aggregate of a sum not exceeding two thousand rupees and an amount equal to twice the excess tax. The management view is not correct as the requirements to impose a fine are not evident in this case.

(b) Following points are considered

- should appeal within thirty days of receiving the determination from Commissioner General of Inland Revenue.
- Shall state the all relevant details of determination(Including name and address of his authorized representative-if any)
- Shall Pay 25% of the tax in dispute to the Commission or produce bank guarantee for the same amount
- To be delivered to the Secretary of Commission

(c) As per the facts given there are three components of the refund claimed;

- WHT deducted (Rs.20,000)
- Error in claiming Refund (Rs.10,000)
- Excess of self assessment payment (Rs. 5,000)

As per the Section 32 of the Inland Revenue Act, Interest which is subject to WHT does not form part of the assessable Income of the individual.

As per the Section200(8) no refund is due in relation to income tax paid by deduction at source , if corresponding income is not included in the assessable income for that year of assessment.

As per the section 200 when the excess tax paid only refund is due. Therefore amount claimed by error is not tax paid in excess and no refund is due.

As no refund is due on the withholding tax and on error in the return, assessors view is correct.

**Answer No.4**

**Part (a)**

| | | | | | |
|---|---|---|---|---|---|
| Standard Supplies | | | | | |
| | **US $** | **LKR** | | | |
| Wickramasigehe | | 2,700,000 | | | |
| Advance | | 187,500 | | | |
| Watson &co. | 1,000 | 120,000 | | | |
| (Note 2) | | | | | |
| | | **3,007,500** | 12% | 360,900 | |
| Suspended Supplies | | | | | |
| Sivagi | | 600,000 | | | |
| KG | | 500,000 | | | |
| | | **1,100,000** | 12% | 132,000 | |
| | | | | | |
| Zero Rated | | | | | |
| Panema | 1,500 | **180,000** | 0% | - | |
| | | | | | |
| | | **4,287,500** | | **492,900** | |
| | | | | | |
| Excluded Supplies | | Nil | | | |
| Total Input Available | | | | | |
| Car | 2,200,000 | 264,000 | | | |
| Hall | 10,000 | 1,200 | | | |
| others | 37,500 | 4,500 | | | |
| | **2,247,500** | **269,700** | | | |
| | | | | | |
| Disallowable Inputs | | (264,000) | | | |
| Allowable inputs | | **5,700** | | | |
| Claimable Inputs-on Zero Rated & Suspended - Note 1 | 1,702 | | | | |
| Claimable Inputs-on Standard | 3,998 | | | (5,700) | |
| VAT Credit note | | | | (1,200) | |
| Gross VAT Payable | | | | 486,000 | |
| SVAT Credit Vouchers | | | | (132,000) | |
| | | | | | |
| Unabsorbed Input VAT B/F -as at 31.12.10 | 38,000 | | | | |
| Unabsorbed Input VAT B/F -as at 30.06.12(Available) | 15,000 | | | | |
| Claimable for July 2012 | 10% | | | (3,800) | |
| Balance Tax Payable | | | | **350,200** | |
| Unabsorbed Input VAT C/F | **11,200** | | | | |
| | | | | | |

| | |
|---|---|
| **Note 1:** | = 5,700 * 1,280,000 = 7,296,000,000<br>= 7,296,000,000 / 4,287,500 = 1,702 |
| | |
| **Note 2:** | ( alternatively 120,000/112*100=107,143) |

**Part (b)**

When a recipient of the supply misplaced the tax invoice, he can claim the input tax by obtaining a copy of the tax invoice clearly marked "Copy Only". Therefore Accountant's view is not correct.

## Answer No. 05

(a) **Receipts**

| | | |
|---|---|---|
| (1) | Membership fees | Rs. 4,800,000 |
| (2) | Entrance fees | Rs. 400,000 |
| (3) | Gross rent | Rs. 2,400,000 |
| (4) | Dividends | Rs. 270,000 |
| (5) | Interest (net) | Rs. 180,000 |
| (6) | Interest (TB) | Rs. 90,000 |
| Total | | Rs. 8,140,000 |

75% of 8,140,000 = Rs. 6,105,000

The amount received from the members (Rs. 4,800,000 + Rs. 400,000) = Rs. 5,200,000

Therefore the assumption is that the club is carrying on a business and accordingly tax should be paid on ***the profit of the business*** and on ***income from other sources***.

Accordingly income tax payable by the club is as follows:

| | | |
|---|---|---|
| | Rs. | Rs. |
| Business receipts | 5,200,000 | |
| Less: expenses | 3,750,000 | 1,450,000 |
| | | |
| Rents | 2,400,000 | |
| Rates | 30,000 | |
| | 2,370,000 | |
| 25% | 592,500 | 1,777,500 |
| | | |
| Dividends | | Nil |
| Interest FD | | Nil |
| Interest TB | | 100,000 |
| Total statutory income, Assessable income and Taxable income | | 3,327,500 |
| Tax payable at 10% | | **332,750** |

(b) **Permanent Establishment**

Meaning: It means a fixed place of business in which a non-resident person carries on a business in the other country.

If a non-resident person carries on a business in the other country without having a permanent establishment, the profit from such business is liable to tax only in the country of residence. If he has a permanent establishment in the other country, the profit arising in other country as is attributable to the permanent establishment is liable to tax in the other country as well.

**Answer No. 06**

(1) For a transaction to be an adventure it should have been undertaken with the intention of making a profit. Mr. Joachim did not acquire the property with the intention of making a profit. the profit he made is merely incidental to the transaction. Therefore it is not a profit from an adventure and is not liable to tax.

(Speldewindvs Cs De Soysa)

(2) The Assessor is right in his view that the cost of the buildings was capital expenditure. Though the buildings were of short duration they were part of the fixed capital assets of the business. They endure the way fixed capital assets endure. Therefore, the cost is not deductible.

(Theobold vs Commissioner of Income Tax)

(3) The payments made by Mr. Wickramasekara are not annuities. The reason is that the payments are made in liquidation of and antecedent liability, namely Rs. 3,000,000 ordered by the District Court. Payment of such an amount in instalment does not make it an annuity nature of the payments made annuities.

(Rajarathnam vs. Commissioner Income Tax)

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