

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE3(A)-Fundamentals of Taxation

March 2017

SECTION 01

Answer 01

1 (a)

1.1

Learning Outcome/s:

1.1.2 - State the principles of taxation and the difference between direct taxes and indirect taxes

Correct Answer: D

1.2

Learning Outcome/s:

3.1.2 - Explain specific adjustments applicable to the computation of statutory income of a company, from rent, interest, dividend and profit from trade or business (other than adjustments applicable for intercompany transaction)

Correct Answer : B

1.3

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

Correct Answer: D

1.4

Learning Outcome/s: 4.5.1 Explain characteristics of withholding tax schemes (WHT on director fees, interest, dividends, sale of gem at auctions, lottery and other prizes) and tax credits where applicable.

Correct Answer: B

1.5

Learning Outcome/s: 3.1.5 page 97

Explain the tax liability of a company distributions and distributable profits.

Correct Answer: A

(2 x 5 = Total: 10 marks)

1 (b)

1.6

Learning Outcome/s: 2.2.3 Calculate statutory income from other sources of income	
Gross rent	= Rs. 900,000
Less: Rates 10% of Rs. 100,000	= (Rs. <u>10,000</u>)
	= Rs. 890,000
Less: 25% allowance for repair	= <u>Rs. 222,500</u>
Net rent	= <u>Rs. 667,500</u>
Rating assessment	= Rs. 100,000
Less: 25% allowance for repairs	= <u>(Rs. 25,000)</u>
NAV	= <u>Rs. 75,000</u>
<u>Net rent > NAV</u>	
Taxable rent income = Rs. 667,500	

1.7

Learning Outcome/s: 3.1.4 Compute gross income tax liability and balance tax liability of a small- or medium-sized company.	
Taxable income	Rs. 7,140,000
Gross tax @ 28%	Rs. 1,999,200
Less: tax credits :	
Self-Assessment payments	Rs. <u>(120,000)</u>
Balance Tax Payable	Rs. <u>1,879,200</u>

1.8

Learning Outcome/s: 4.4.2 Explain penalties and discount application on the payment of tax
If tax is not paid on the due date, a penalty of 10% of such tax is added. If it is not paid within 30 days from the due date a further penalty of 2% for every 30 days or part thereof. maximum penalty is 50% of outstanding tax

1.9

Learning Outcome/s: 5.1.3 - List a few supplies exempted from tax and explain the difference between exempted and zero-rated supplies.
When a supply is zero rated, it means the supply is liable to tax, but the rate is zero. If the supply is exempted, it is not liable to VAT. In the case of zero rated supplies, the person is entitled to claim input taxes though the output tax is nil. In case of exempted supplies, he cannot claim input tax since he cannot charge VAT on his supplies.

1.10

Learning Outcome/s: 5.2.3 Compute tax payable for a given straightforward non- complex scenario			
NBT on Sales	4,860,000 @ 2%		97,200
Less : NBT paid on imported raw materials			45,000
NBT paid on services - not allowed		12,000	
Balance NBT payable			52,200

(2 x 5 = Total: 10 marks)

SECTION 2

Answer 02

Learning Outcome/s: 3.1 Basic understanding of income tax liability of a resident company (non-complex straightforward scenario)

Sarasi Fashions (Pvt) Ltd
Gross tax liability and balance tax payable for the year ended 31 March 2016

	Rs.
Profit before tax	14,750,000
Less: Interest income – other sources of income	(27,000)
Gratuity provision	2,230,000
Gratuity paid	(750,000)
Donation	800,000
Legal expenses to acquire a land	100,000
Legal expenses - bad debt recovery allowed	_____ -
Adjusted profit from trade	17,103,000
Other sources of income:	
Interest income (27,000 x (100/90) - gross	_____ 30,000
Total Statutory Income	17,133,000
Less: Losses b/f	3,500,000
Limited to 35% of Total statutory income	5,996,550
Therefore can be claimed full amount	<u>(3,500,000)</u>
Assessable income	13,633,000
Less: allowance for qualifying payments:	
Donation to Pradeshiya Sabha – 100% claimable	<u>_(800,000)</u>
Taxable Income	<u>12,833,000</u>
Gross Tax Payable @ 28%	3,593,240
Less: Tax credits:	
ESC brought forward	(1,500,000)
Notional tax credit	<u>_(3,000)</u>
Balance Tax Payable	<u>2,090,240</u>

(Total: 10 marks)

SECTION 3

Answer 03

Learning Outcome/s:

- 2.2 Statutory income form 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

Gross tax liability and balance tax payable by Pasindu for the Y/A 2015/16

Salary	175,000 x 12	2,100,000	
Value of conveyance (35,000 x 12) = Rs. 420,000 (exempted lower of value of one vehicle facility or Rs. 50,000 p.m)			
Medical bills		55,000	
Foreign Accommodation	not taxable		
Foreign travelling - Air ticket	not taxable		
Approved employer's contribution EPF 12%	not taxable		
Total employment income			2,155,000
Dividend income			
Net dividend (<i>not a part of AI</i>)			
From a unit trust - exempt			
Interest income			
Fixed deposit interest (Net) - <i>not a part of AI</i>			
Interest from RFC accounts - exempt			
Business Income			
Net profit as per accounts		1,537,500	
Add: Accounting depreciation (35,000 + 30,000)		65,000	
Advertising 25% disallowed (23,000* 25%)		5,750	
Lease interest		46,500	
Total lease value (12,000 x 36)	432,000		
1/4 th of total lease value	108,000		
Lease rentals paid during the year	132,000		
Lower amount - Allowed		(108,000)	
Personal life insurance		15,000	
Depreciation allowance :			
- leased computers - not entitled			
- office equipment 240,000* 33.33%		(80,000)	
Adjusted business profit			1,481,750
Total Statutory Income			3,636,750
Less: Deductions under Sec. 32 :			
Housing loan - Interest Paid (limited to other income)			(392,000)

Assessable Income		3,244,750
Less: Allowance for Qualifying payments :		
Life Insurance premium	(15,000)	
donation to an approved charity	<u>(100,000)</u>	
Limited to lower of 1/3 of AI or Rs.75,000/- or actual	<u>(115,000)</u>	(75,000)
Capital repayment on housing loan applicable only for professionals (limited to other income)		(438,000)
QP on employment income		(250,000)
Tax free Allowance		(500,000)
Taxable income		1,981,750
<u>Tax liability</u>		
On First Rs. 500,000 @ 4%		20,000
On Next Rs. 500,000 @ 8%		40,000
On Business income Rs. 576,750 @ 10%		57,675
On balance Rs. 405,000 @ 12%		<u>48,600</u>
		166,275
Less: Tax credits:		
Self-Assessment payments		(40,000)
PAYE		<u>(108,600)</u>
Balance Payable		<u>17,675</u>

(Total: 20 marks)

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