

CA



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

# SUGGESTED SOLUTIONS

## **15304–Advanced Taxation and Strategic Tax Planning**

CA Professional (Strategic Level I) Examination  
December 2013

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

**Answer No. 01**

**Express Bank PLC  
Computation of Taxable Income & Income Tax Payable  
For the Y/A 2012/13**

**Sources of Income**

			Rs.'000
Profit from Business-(Schedule-01)			755,705
Interest Income (net)	184,000		
Gross	((184,000/90) x 100)		204,444
Income from business of finance lease			<u>18,167</u>
<b>Total Statutory Income</b>			<b>978,316</b>
Deductions from TSI			
Trade Losses b/f from leasing business in 2010/11- (Cannot be Claimed)		27,000	
Trade Losses b/f from leasing business in 2011/12		42,000	
Can only be claimed up to the level of leasing profits		<u>(18,167)</u>	(18,167)
C/F		<u>23,833</u>	
Trade loss from foreign currency banking - offshore-(Limited to 35% of SI)		155,000	<u>(155,000)</u>
<b>Assessable Income</b>			<b>805,149</b>
Qualifying Payments			
Donations to approved charities		70,000	
Limited to 1/5 of AI or 500,000/-		<u>(500)</u>	(500)
	Not Allowed to C/F	<u>69,500</u>	
<b>Taxable Income</b>			<b><u>804,649</u></b>
Tax Liability			
On Taxable income	804,649	@28%	225,302
Tax on Dividend Distributed	Total Dividend	358,000	
Less: Dividend declared out of Dividend Received		<u>258,000</u>	
		100,000	10%
			<u>10,000</u>
<b>Total Tax Payable</b>			<b>235,302</b>
Less: Tax payments			(250,000)
Notional tax credits on interest on treasury bills			<u>(20,444)</u>
<b>Balance Tax Payable/(Refund Due)</b>			<b><u>(35,142)</u></b>

**Schedule: 01****Adjusted Profit From Trade Y/A 2012/13**

				+	(-)
Net Profit / (Loss) Before Tax				1,763,000	
Income exempt - Interest income under Section 13				-	(785,000)
Interest Income (net)				-	(184,000)
Dividend Income				-	(258,000)
Profit from business of leasing				-	(37,500)
Recovery of loan written off (Allowed previously is an income)				-	-
Recovery of interest written off is a receipt from the trade				-	-
Interest written off-Allowable				-	-
Loan written off is bad debt which is allowable				-	-
Staff Training-Allowed				-	-
<u>Disallowable Expenses</u>					
Provision for loan loss - Specific				423,000	
- General				168,000	
Allowed Loan Losses 1% of Loans( 52,600+ 7,250) x 1%				<u>(598,500)</u>	
Total Specific Provision made in accounts				423,000	
Add: Prior year excess of 1% B/F				<u>30,000</u>	
				453,000	
Less: Allowed this year				<u>(598,500)</u>	(453,000)
No Excess to C/F to Y/A 2013/14				<u>0</u>	
Finance VAT				388,500	
Advertisements 1/4	14480*1/4			3,620	
Legal Expense - Money recovery			allowed	-	
Entertainment				7,860	
Donation				80,000	
Profit on disposal					(2,200)
Depreciation				74,000	
Tax on Tax paid				14,250	
Investment impairment losses				17,300	
Amortization of Intangible Assets				300,000	
Allowed- 10% of Intangible Asset (2,300,000 x 10%)					(230,000)
Stamp Duty				500	
Provision for staff retirement				186,000	
Payment of staff retirement benefits					(346,000)
<b>Trade receipt on disposal</b>					
	Furniture	Computers	Vehicles		
Sale price	-	6,000	8,000		
TWDV	<u>( 2,800)</u>	<u>(5,000)</u>	<u>(2,000)</u>		
Trade receipt/(Loss) on disposal	<u>( 2,800)</u>	<u>1,000</u>	<u>6,000</u>	4,200	

**Capital Allowances on Additions during the year  
On Computers**

BWDV of the addition	130,000			
Rate of depreciation	20%			
Cost	162,500			
Rate of depreciation allowance	25%			
				(40,625)

**Capital Allowances on Assets B/F**

		Disposal	Rate	Year		
Computers	125,000	(5,000)	25%	2009/10	-	(120,000)
Furniture and Fittings	47,500	(2,800)	20%	2008/09	-	(44,700)
Motor Vehicles	26,000	(2,000)	20%	2008/09	-	(24,000)
Computer Software	149,500	-	25%	2009/10	-	(149,500)
					<u>3,430,230</u>	<u>(2,674,525)</u>

**Adjusted Profit /(Loss) on banking business 755,705**

**Schedule: 02**

**Adjusted profit from business of leasing**

Accounting profit as per accounts				37,500
<u>Less</u> : Capital Allowances				
<b>Motor Cars-Finance Leases</b>		30,000	20%	(6,000)
<b>Equipment-Finance Leases</b>		40,000	33.3%	<u>(13,333)</u>
Adjusted Profit from business of leasing				<u>18,167</u>

**Computation of Distributable Profits**

Book Profit As per the Financial statements				1,763,000
Income tax liability (As per the computation)				<u>(225,302)</u>
				1,537,698
Add: Amotization of Intangible Assets				300,000
Depreciation for the additions-Cost of the additions			162,500	
		Rate of depreciation	20%	<u>32,500</u>
				1,870,198
Less: Purchase of Fixed Assets				162,500)
<b>Distributable Profit</b>				<b><u>1,707,698</u></b>
Minimum Distribution as per Section 61				170,770

Value addition in the case of a business providing financial services will be computed as follows:

The value addition will be calculated on the profit adjusted for economic depreciation and emoluments payable to all the employees of such financial institution

The profit is the book profit before deduction of depreciation and personal cost services. After 1.01.2011 based on the profit after deduction of Value Added tax payable on financial services.

Vale addition of Financial Services

Net profit/loss before tax (accounting)		xx
+Depreciation charges accounting	xx	
+Staff remuneration		
Remuneration on the basic apply for PAYE (cash +non cash + vehicle etc.)	xx	
-Economic depreciation		<u>x</u>
Total value addition		xx
value addition		<u>(x)</u>
Total financial value addition		<u>xx</u>

NOT FOR SALE

**Answer No. 02**

**Computation of Income tax liability of Mr. Silva  
For the Y/A 2012/13**

				Rs
Sources of Income				
<b>Income from Trade (Note-01)</b>				13,440,000
<b>Dividend Income</b>				
Received from company outside Sri Lanka through a bank( <b>Exempt</b> )				-
Received from out of exempt profit( <b>Exempt</b> )				-
Dividend from ABC PLC				100,000
Dividend received in a form of debentures				200,000
Income from Interest				100,000
<b>Employment Income</b>				
		Gross Per	Per year	
		Month		
Director fees	ABC Company	33,333	400,000	
	PQR Company	10,000	<u>120,000</u>	
				520,000
		Employment income exempt under Section 08	<u>(20,000)</u>	500,000
Rent Income(Net)				
	Gross rent			1,080,000
	Less: Rates			<u>(21,000)</u>
				1,059,000
	Less:25% for repairs			<u>(264,750)</u>
				<u>794,250</u>
<b>Total Statutory Income</b>				<b>15,134,250</b>
Less: Statutory Deductions				
Interest Income-8% WHT Paid				(100,000)
Dividend-10% WHT Paid				(100,000)
Interest Paid on the housing loan				<u>(247,000)</u>
<b>Assessable Income</b>				<b>14,687,250</b>
Tax free allowance				(500,000)
Qualifying payments		Allowed		
	Medical Insurance Rs.			
	80,000			75,000
	Special health Insurance for incurable diseases			<u>142,000</u>
				<u>(217,000)</u>
<b>Taxable Income</b>				<b><u>13,970,250</u></b>

### Computation of Tax liability

Dividend received in the form of debenture	200,000	10%	20,000
	500,000	4%	20,000
	500,000	8%	40,000
	<u>12,770,250</u>	10%	<u>1,277,025</u>
	<u>13,970,250</u>		<u>1,357,025</u>

### **Less: Tax Credits**

Quarterly Payments			(68,000)
PAYE on Directors fees	ABC	64,000	
	PQR	12,000	(76,000)
Tax credit on dividend			(20,000)
Tax paid by the Partnership (Within the limit allowed)			<u>(598,004)</u>
<b>Balance Tax Payable</b>			<b><u>595,021</u></b>

### Income from Trade (Note-01)

Profit of partnership after depreciation and Salaries			22,000,000
Partners salary			12,000,000
Add: Depreciation			<u>1,600,000</u>
Divisible Profit			<b><u>35,600,000</u></b>

### **Distribution of Divisible Profit.**

	Silva	Others	Total
Partners Salary	4,000,000	8,000,000	12,000,000
Balance Share of Profit(40:60)	<u>9,440,000</u>	<u>14,160,000</u>	<u>23,600,000</u>
	<u>13,440,000</u>	<u>22,160,000</u>	<b><u>35,600,000</u></b>
Partnership tax paid			1,584,000
Share of Partnership Tax of Mr. Silvas	(13440/35600) x 1,584,000/-		<u>598,004</u>

(b)

From 01/4/2008 income received from companies outside Sri Lanka to any shareholder resident in Sri Lanka is exempt, if such dividend has been received through a bank. If not received through a bank, such dividend is liable to income tax as per the 5th Schedule subject to the provision of any double tax treaty agreement for avoidance of double taxation.

**Answer No. 03**

**DASA INDUSTRIES**  
**DIVISIBLE PROFIT/(LOSS) FOR THE Y/A 2012/13**

<b>Net Profit /(Loss)as per Accounts</b>			4,600,000
<b>Less: Rent Income</b>			(600,000)
Disposal of Lathe Machine			<u>(200,000)</u>
			3,800,000
<b>Add: Disallowed Expenses</b>			
Partner Salary	<b>Munidasa</b>		1,200,000
Partners Interest on Capital	<b>Munidasa</b>	200,000	
	<b>Gunadasa</b>	<u>300,000</u>	500,000
Royalty paid Gunadasa of his patent			600,000
Rates applicable for premises let			<u>10,000</u>
			6,110,000
<b><u>Disposal of Lathe Machine</u></b>			
Sale Proceeds	200,000		
Less: Tax WDV	<u>-</u>	<u>200,000</u>	<u>200,000</u>
Fully depreciated as it exceeds 8 years			
			6,310,000
Royalty paid Gunadasa of his patent- <b>Allowed</b>			<u>(600,000)</u>
			<b>5,710,000</b>
<b><u>Divisible Profit</u></b>			
<b><u>Add: Other Income</u></b>			
Rent Income- <b>Rent</b>			
Gross	600,000		
Rates	<u>(10,000)</u>		
	590,000		
25% Repairs	<u>(147,500)</u>		<b>442,500</b>
			<b>6,152,500</b>
Less: Tax Free Allowance			(600,000)
Taxable Income			<b>5,552,500</b>
<b>8% Partnership Tax</b>			<b><u>444,200</u></b>



<b>Distribution of Divisible Profit</b>	<b>Munidasa</b>	<b>Gunadasa</b>	<b>Total</b>
Salaries	1,200,000	-	1,200,000
Interest on capital	200,000	300,000	500,000
Balance Share of Profit	<u>2,005,000</u>	<u>2,005,000</u>	<u>4,010,000</u>
	<b>3,405,000</b>	<b>2,305,000</b>	<b>5,710,000</b>
<b>Distribution of Other Income-Rent</b>	<u><b>221,250</b></u>	<u><b>221,250</b></u>	<u><b>442,500</b></u>
	<u><b>3,626,250</b></u>	<u><b>2,526,250</b></u>	<u><b>6,152,500</b></u>
<b>Effective Rate</b>	<b>59%</b>	<b>41%</b>	
<b>Attributable Partnership Tax</b>	<u><b>262,078</b></u>	<u><b>182,122</b></u>	<u><b>444,200</b></u>
 <b><u>Tax payable by Munidasa</u></b>			
Share of Profit-Income from Trade			3,405,000
Rent Income			<u>221,250</u>
			3,626,250
Less: Personal Allowance			<u>(500,000)</u>
Taxable Income			<u>3,126,250</u>
 <b>Tax Payable</b>			
	500,000	@ 4%	20,000
	500,000	@ 8%	40,000
Manf. Business Income	1,905,000	@ 10%	190,500
Other Income	<u>221,250</u>	@ 12%	<u>26,550</u>
	<u>3,126,250</u>		<b>277,050</b>
 <b>Less: Tax Credit partnership Tax</b>		262,078	
Limitation(Within the limit)			<b>(262,078)</b>
<b>Balance tax Payable</b>			<u><b>14,972</b></u>

**Answer No. 04**

a)

**Mc Niven Shipping Company Pvt Ltd**

**VAT Computation for the Month of March 2012**

<b>Out Put VAT</b>	<b>EXEMPT/EXCLUDED</b>	<b>LIABLE</b>	<b>RATE</b>	<b>OUTPUT VAT</b>
International Transportation- Goods & Passengers		68,000,000	0%	-
Coastal Shipping	-	12,000,000	12%	1,440,000
Charter Hire	12,000,000	-		-
	12,000,000	80,000,000		1,440,000
<b>In Put VAT</b>				
VAT on Repair on Charter Hire(Not Allowed as supply is not liable)		2,500,000		-
Other Ships		8,680,000		
Limited to 100% of Out Put VAT		(1,440,000)		(1,440,000)
<b>Excess Input VAT C/F</b>		<b>7,240,000</b>		
Balance VAT Payable				-

- (b) The international transportation( including transshipment of goods or passengers) as are specified by the Commissioner-General by Notification published in the Gazette
- From a place in Sri-Lanka to a place outside Sri Lanka
  - From a place outside Sri-Lanka to a place in Sri Lanka
  - From a place outside Sri-Lanka to a place outside Sri Lanka

### Answer No. 05

- (a) When the transaction under consideration is a disposal of a property, if the profit arising is to be considered as a profit arising from an adventure, the element of adventure should be present from the very beginning, i.e. at the time of acquiring the property. In other words, the property should have been acquired with the intention of embarking upon an adventure. (Speldwinde Vs Commissioner of Income Tax) In the present case, since the property is an inherited property that requirement is absent. The present case, though it contains characteristics of trading is an instance of the disposal of a property to the best advantage. Therefore, the profit arising is not a profit from an adventure.

According to section of the Inland Revenue Act a non-resident person is liable to tax in Sri Lanka on income and profits arising from, *inter-alia*, business transacted in Sri Lanka.

- (b) Business is transacted in the location in which the contacts or the agreements pertaining to business transactions are concluded. (Anglo Persian Oil Company Ltd Vs Commissioner of Income Tax) . In the present case since the orders from the Sri Lankan customers are accepted in the United Kingdom the contracts should be treated as concluded in UK. Therefore, the UK company does not have any business transacted in Sri Lanka and therefore, there is no liability to tax in respect of the profits arising to the UK company from the monies received from Sri Lankan customers.
- (c) An annuity is a recurring payment made in discharge of a legal obligation. If the payer of the amounts sought to be treated as annuities receives something in return for the payment the payments in question are not annuities. In the present case the payments are made in exchange of the value of a business interest. Therefore, it is not an annuity. It is payments made in installments for the acquisition of the business interests. (Dr. B D J De Silva Vs Commissioner of Inland Revenue or Nilgiriya Vs Commissioner of Inland Revenue or JM Rajaratnam Vs Commissioner of Inland Revenue). The description of the payment as an annuity in the agreement is not conclusive of whether it is an annuity or not.

### Answer No. 06

- (a) The circumstances require quick action so that the revenue due to the government would be protected. However, any action taken should be according to the law. The applicable provision requires a default notice served on a defaulter before recover action is initiated. But in circumstances similar to the present circumstances the provision permits the issue of the default notice after taking steps for the recovery. Therefore, what the assessor should do in the present circumstances is to have a notice issued on the bank under section 180 of the Act and to issue a notice of default within two weeks from the date of the notice to the bank.
- (b) Section 183 of the act gives authority to recover taxes due from a partner from the partnership assets. This is subject to two conditions.
1. It is only the tax attributable to the defaulting partner's share of divisible profit that can be recovered.
  2. The amount should be restricted to the value of the defaulting partner's interest in the partnership business.



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